(a)

No. 95-860-CSX
Status: GRANTED

Title: Barbara Smiley, Petitioner
v.
Citibank (South Dakota), N. A.

Docketed:
December 1, 1995

Court: Supreme Court of California

Counsel for petitioner: Donovan,Michael

Counsel for respondent: Kendall,Richard B.

Ptn due & mld 11-30-95, see ml label re dkt dt.

Entry	Date	Note	Proceedings and Orders
1	Nov 30 1995	G	Petition for writ of certiorari filed. (Response due December 31, 1995)
4	Dec 19 1995		Brief of respondent Citibank (South Dakota), N.A. in support of petition filed.
2	Dec 20 1995		Brief of amici curiae the American Bankers Association, et al. filed.
5	Jan 3 1996		DISTRIBUTED. January 19, 1996 (Page 3)
6	Jan 19 1996		Petition GRANTED. The brief of petitioner is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, March 1, 1996. The brief of respondent is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, March 29, 1996. A reply brief, if any, is to be filed pursuant to Rule 25.3. Rule 29.2 does not apply. **
7	Feb 16 1996		SET FOR ARGUMENT WEDNESDAY, APRIL 24, 1996. (2ND CASE).
8	Feb 29 1996		Joint appendix filed.
9	Feb 29 1996		Brief of petitioner Barbara Smiley filed.
11	Feb 29 1996		Brief amicus curiae of Bankcard Holders of America filed.
14	Feb 29 1996		Brief amici curiae of Trial Lawyers for Public Justice, et al. filed.
10	Mar 1 1996		Brief amicus curiae of Consumer Action filed.
12	Mar 1 1996		Brief amici curiae of National Consumer Law Center, et al. filed.
13	Mar 1 1996		Brief amici curiae of Massachusetts, et al. filed.
15	Mar 15 1996		CIRCULATED.
16	Mar 26 1996	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
26	Mar 28 1996		Record filed.
		*	Original record proceedings Supreme Court of California (4 BOXES).
18	Mar 29 1996	X	Brief of respondent Citibank (South Dakota), N.A. filed.
20	Mar 29 1996	X	Brief amici curiae of American Bankers Association, et al. filed.
21	Mar 29 1996	X	Brief amici curiae of Colorado, et al. filed.
22	Mar 29 1996	X	Brief amici curiae of Greenwood Trust Company, et al. filed.
23	Mar 29 1996	X	Brief amicus curiae of New York Clearing House Association filed.
24	Mar 29 1996	X	Brief amici curiae of Affinity Group Marketing and Union National Association filed.

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No. 95-860-CSX

Entry	Date	Note	Proceedings and Orders
25	Mar 29 1996	X	Brief amicus curiae of United States filed.
17	Apr 1 1996		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
27	Apr 12 1996	G	Motion of the Attorney General of Indiana to withdraw as amicus curiae filed.
28	Apr 16 1996	X	Reply brief of petitioner filed.
29	Apr 22 1996		Motion of the Attorney General of Indiana to withdraw as amicus curiae GRANTED.
30	Apr 23 1996		LODGING consisting of one copy of "The Economics of Credit CArds (Jan. 1993) submitted by counsel for the respondent.

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

Petition For A Writ Of Certiorari To The California Supreme Court

PETITION FOR A WRIT OF CERTIORARI

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264 pp

QUESTIONS PRESENTED

1. Did Congress intend South Dakota's legislative definition of "interest" to define the federal term "interest" in Section 30 of the National Bank Act, 12 U.S.C. § 85 ("§ 85"), and thereby displace other states' contract laws limiting the form or the amount of liquidated damages for late payments on revolving credit accounts?

2. May Congress constitutionally delegate to South Dakota the power to define the federal lending term "interest" for all fifty states so as to preempt other states' contract laws?

3. As a matter of federal law, does the term "interest at the rate" in § 85 include contingent, sum-certain penalty charges (late fees), so as to preempt state limitations on the form or the amount of contractual liquidated damages on revolving credit accounts?

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Barbara Smiley respectfully petitions for a writ of certiorari to review the judgment entered below by the California Supreme Court. Based on its reading of *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), the California Supreme Court held that the lawfulness of Citibank's loan charges has been entrusted to the bank's home state so that the laws of South Dakota operate to preempt conflicting California contract laws limiting liquidated damages on credit cards held by California residents.

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court (App. 1-72) are published at 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995). The majority and dissenting opinions of the California Court of Appeal (App. 74-98) are published at 26 Cal. App. 4th 1767, 32 Cal. Rptr. 2d 562 (1994). The opinion of the California Superior Court (App. 99-105) is unreported.

JURISDICTION

The California Supreme Court entered its judgment (App. 1-72) on September 1, 1995. Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, section 1 of the United States Constitution directs, in pertinent part, that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. art. I, § 1.

The Supremacy Clause provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the

> Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Full Faith and Credit Clause requires, in relevant part, that "Full Faith and Credit shall be given in each State to the public Acts, Records, and Judicial Proceedings of every other State." U.S. Const. art. IV, § 1.

Section 30 of the National Bank Act, as codified at 12 U.S.C. § 85, provides, in pertinent part:

> Any [national bank] may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under state laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. . . .

Prior to codification, Section 30 of the National Bank Act also provided what is now codified, in pertinent part, in 12 U.S.C. § 86:

> The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action on debt, twice the amount of the interest thus paid. . . .

The California Civil Code section 1671 states, in relevant part:

> (b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.
>
> (c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:
>
> (1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or
>
> (2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.
>
> (d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

STATEMENT

The California Supreme Court held that the law of a bank's home state, in this case South Dakota, provides the definition of "interest" in § 85 and serves to preempt California's regulation of liquidated damages for a breach of a credit card contract held by a California consumer. Can South Dakota enlarge the definition of a federal term

in a federal statute and thereby determine and expand the scope of federal preemption? Can one state preempt without limitation the consumer protection and contract laws of all the other states? These are fundamental constitutional questions that should be addressed by this Court.

A. Background and Facts

This case challenges the expansive reading of § 85 of the National Bank Act adopted by a divided California Supreme Court. Congress passed the National Bank Act in 1864 against the backdrop of the Civil War. The Act had two purposes – to establish a national banking system with a uniform national currency and to prevent states from discriminating against national banks. To prevent discrimination, Congress crafted into the Act a number of protective provisions,[1] including, most notably, § 30,[2] now codified as § 85 and 12 U.S.C. § 86 ("§ 86"). Section 85 embodies the "most favored lender" doctrine enunciated by this Court in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874). The doctrine allows a national bank to charge the highest "rate" of "interest" allowed by its home state. Section 85 also provides an alternative federal interest rate not measured by state law and permits a national bank to charge whichever of the two interest rates is higher. Section 86 then provides the penalty (twice the amount of interest charged) applicable in the event the bank charges more than the allowed rate.

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[1] For example, to prevent states from passing discriminatory contract laws that might prevent a national bank from entering into contracts on terms as favorable as those of other businesses, Congress enacted § 24 (Third) of the Act, 12 U.S.C. § 24 (Third). That statute provides the general contracting powers of national banks. *See Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 239, 247-53 (1944) (upholding non-discriminatory state escheat statute).

[2] Act of June 3, 1864, Ch. 106, § 30, 13 Stat. 108 (1864), *as amended and codified in* 12 U.S.C. §§ 85 & 86 (1982).

Congress enacted these provisions intending the term "interest" to have a firm, federal definition that would not depend on unique state definitions. *See Tiffany*, 85 U.S. at 410 (holding that "interest" must "receive a strict, that is literal construction" to avoid subjecting banks to the penalty of double the interest collected). Although the arithmetic limit of the allowed rate of interest could vary from state to state, the meaning and substantive components of "interest" for national banks would be uniform throughout the country. In other words, the federal law incorporates only the rate ceilings of a bank's home state, not the varying definitions of the states. *See National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (construing *Tiffany* and holding that only the "*rate*" of interest is federalized by § 85, not the character of the contracts banks are authorized to make (emphasis in original)).

Years later, this Court, in *Marquette*, considered the meaning of the word "located" in § 85 and the preemptive scope of the statute. *See* 439 U.S. at 313-19. Announcing what has become known as the "exportation" doctrine, the Court held that "located" has a firm, federal definition so that a national bank may "export" its home state's *interest rate* into other states. *See id.* The Court did not, however, define the terms "interest" or "rate," nor did it hold that the laws of a national bank's home state govern all the contractual terms or charges (other than "interest" as defined by Congress) imposed on consumers in other states.

Since *Marquette*, several small states (the "bank friendly states") and numerous banks have attempted to expand the "exportation" doctrine beyond the parameters established by this Court and Congress. During the 1980s, some of those states, most notably South Dakota, the current home of Citibank (South Dakota), N.A. ("Citibank" or "the bank"), and Delaware, sought to attract large credit card operations by deregulating banking and repealing consumer protection laws. *See* Federal Reserve

Bank of Chicago, "Small States Teach a Big Banking Lesson," *Chicago Fed. Letter*, No. 10 (June 1986).[3] Against the backdrop of *Marquette*, those states passed unique legislation that, contrary to the common law, defined "interest" as including late fees, attorneys fees and other contract terms and penalties. The idea was to allow national and other banks in those states to "export" the terms and penalties into other states under the guise of "interest," a prospect that goes well beyond the exportation allowed under *Marquette*.

The present case challenges the exportation of contract penalties by Citibank. From South Dakota, Citibank issues Visa cards and Mastercards to customers nationwide. (App. 110). Citibank charges these customers not only a hefty annual percentage rate, but also a separate and additional $15 late charge if a specified minimum payment is not received within a certain number of days after the payment due date. Citibank charges the $15 flat fee regardless of the outstanding balance, the amount of the payment owed, or the actual number of days the

[3] The bank friendly states' efforts to entice credit card issuers to relocate from other states have been wildly successful. *See Chicago Fed. Letter, supra*. Today, of the top ten issuers, six are located in Delaware, while a seventh, Citibank, the single largest issuer of Visa cards and Mastercards, is located in South Dakota. To keep even more card issuers from relocating to these deregulated states, other states have been forced to relent and repeal consumer protection statutes limiting penalty charges and other non-interest fees. *See id*. As this race to the bottom has unfolded, more and more consumers have lost the ability to effect legislative checks on oppressive or unfair contract terms. If the federal term "interest" means "all lending terms," as Citibank has argued, and if only the laws of a bank's home state may define and regulate those lending terms, then § 85 has pitted state against state, making it politically impossible, as a practical matter, for citizens to effect legislative change on the local or even the national level.

payment is late. (App. 114). In addition, Citibank's cardmember agreement treats the late payment as a technical breach of the contract and does not waive the default even if the late fee is paid. (App. 117 & 122). Bearing no relationship to the amount owed, the passage of time or the bank's loss resulting from a delay in payment, and imposed in addition to continuing finance charges, the late fee is a classic contract penalty that exceeds any reasonable provision for liquidated damages. (App. 114-115).

Citibank charges its late fees in every state, including those that prohibit or limit such liquidated damage provisions. California is one of the states that regulates contractual liquidated damages. Here, Citibank exported its late fees into California and imposed them on Petitioner Barbara Smiley ("petitioner" or "cardholder") and other California residents in violation of California law. In response, cardholder filed this consumer class action on July 7, 1992, on behalf of herself and all other California residents who have been charged late charges on credit cards issued by Citibank.[4] (App. 106-128).

[4] Cardholder's complaint alleges that Citibank's $15 late fee is a grossly excessive penalty that violates California's prohibitions against (1) excessive liquidated damage contract provisions (*i.e.*, unlawful penalties), California Civil Code § 1671; (App. 121-122); (2) unlawful, fraudulent or unfair business acts or practices (App. 118-120); (3) breaching the duties of good faith and fair dealing (App. 120-121); (4) unjust enrichment (App. 122-123); (5) fraud and deceit (App. 123-124); (6) negligent misrepresentation (App. 125); and (7) breach of contract (App. 125-126).

B. How the Federal Question Was Presented and Resolved Below

After this case was removed to federal court and then remanded back to the California Superior Court,[5] Citibank presented the federal question in moving for judgment on the pleadings. Relying primarily on *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *reversing* 776 F. Supp. 21 (D. Mass. 1991), *cert. denied*, 113 S. Ct. 974 (1993), Citibank contended that California law regulating penalty charges is preempted by § 85. The trial court, on July 6, 1993, denied the bank's motion. Citibank then petitioned the state court of appeal for a writ of mandate. After the court of appeal issued an alternative writ, the trial court, on September 14, 1993, entered a minute order dismissing cardholder's complaint. (App. 99-105).

Cardholder filed a notice of appeal on September 23, 1993. Following briefing and oral argument, the court of appeal, by a two-to-one majority, affirmed the trial court. The court of appeal concluded that "the late charges here are governed solely by 12 U.S.C.A. § 85 and § 86," and that "California law purporting to regulate such charges is preempted." (App. 84). Justice Johnson of the court of appeal dissented. He reasoned that the majority, and the authority on which it relied, "neglect[ed] a vital distinction between the payments and fees defined as 'interest' . . . and the family of costs and consequences of which 'late payment fees' are a member." (App. 95). On August 22, 1994, cardholder petitioned the California Supreme Court to review the court of appeal's ruling. The court granted review on October 27, 1994. (App. 73).

[5] On August 5, 1992, Citibank, asserting diversity jurisdiction, removed the action to the United States District Court for the Central District of California. Cardholder then moved to remand the case back to state court, and the federal court granted that motion. *Smiley v. Citibank (South Dakota), N.A.*, 863 F. Supp. 1156 (C.D. Cal. 1993).

On September 1, 1995, the California Supreme Court, in a five-to-two decision, affirmed dismissal of the case. (App. 1-72). The foundation of the majority's analysis was essentially threefold. First, extending *Marquette* beyond its context and holding, the majority reasoned that § 85 entrusts the lawfulness of a national bank's loan-related charges exclusively to the bank's home state, notwithstanding the laws of any other state. (*See* App. 13). The issue for the majority, then, was the *scope* of the preemption under § 85. The scope of that preemption, the majority reasoned, turned on the meaning of "interest" in § 85. (App. 14).

Second, to define "interest," the majority purportedly looked to the meaning of the term when § 85 was enacted. Stating that the dictionary definition at that time was "compensation for the loan or use of another sum," or "compensation paid by the . . . debtor to the creditor for its use," the court speculated that such "interest" could include both "a periodic charge based on a percentage of a certain sum . . . payable absolutely by maturity" *and* "a late payment fee, payable contingently in the event of default." (App. 18-19). The court further speculated that a late payment fee could be calculated as either a periodic percentage charge or as a flat fee. (App. 19).

Third, the majority turned to the most favored lender doctrine which, as enunciated in *Tiffany*, precludes states from discriminating against national banks with respect to interest rates. The court expanded that doctrine beyond the "strict, that is literal construction" mandated by *Tiffany* to reach not just rates of interest measured by time and the balance owed, but also all of the lending terms allowed by a bank's home state:

> Congress must have known that unfriendly state legislation could be predicated on measures other than differential provisions concerning periodic percentage charges payable absolutely by maturity. . . . *Had Congress intended to limit protection, it would doubtless have*

made itself plain. It did not. Its silence is especially deafening. . . .

(App. 24, emphasis added). The majority then concluded that the term "interest" in § 85 "should be construed to cover late payment fees, if such fees are allowed by a national bank's home state." (App. 25).

Two justices of California's high court dissented. Justice Arabian pounced on the majority's inference of Congressional intent. He noted that while Congress used the word "interest" in § 85 a total of four times, it used the word "rate" nine times – more than twice as often as the term "interest." (App. 45). Emphasizing that *"'interest' does not appear in a single sentence of section 30 unaccompanied by the word 'rate'"* (*id.*, emphasis in original), Justice Arabian concluded that Congress most likely had in mind a narrower definition of "interest" – "a sum linked to the lending of money calculated at a *rate* or a percentage of the loan over time." (App. 46, emphasis in original).

Citing *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992), Justice Arabian also noted that because exportation is a matter of federal preemption, if Congress's intent to preempt state regulation of late fees is less than "clear and manifest," there is no preemption. (App. 59). He argued that, here, Congress's intent to displace credit terms other than "interest" was far less than clear and manifest. He emphasized that national banks are not immune from basic conflicts of law principles and are governed in their daily course of business far more by state laws than the laws of the nation. (*See* App. 60). Since Citibank had not shown that application of California's liquidated damages law would in any sense "incapacitate" banks from carrying out their duties as federal instrumentalities, Justice Arabian would have held that § 85 did not preempt California's contract laws limiting late fees on credit cards. (App. 61).

Justice George separately dissented, observing that a late fee for a fixed sum, unrelated to the amount or time period of the loan, and assessed only if the borrower is

late with a payment, is a penalty at common law, not interest. (App. 65-66). Arguing that the same was true back in 1864, Justice George cited *Spain v. Hamilton's Administrator*, 68 U.S. (1 Wall.) 604, 626 (1863) and *Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 224 (1830), both of which made clear that a late fee, the payment of which was contingent upon the borrower's own conduct, would not be considered interest for the purpose of determining whether the loan exceeded the legally permitted interest rate. (App. 67-68).

Justice George also criticized the majority's most favored lender analysis. In the absence of § 85, he observed, a state still could not discriminate against a national bank. He reasoned that if § 85 were the sole impediment to discrimination – as assumed by the majority – then a variety of other matters subject to state regulation would have to be deemed "interest," such as building permits, minimum wages and health and safety requirements. (*See* App. 70). Justice George therefore rejected the majority's package preemption analysis because its anti-discrimination premise was without limit and would lead to absurd results. (*See* App. 71). Justice George would have held that § 85 was limited to "rates" of interest so that other lending terms could not be exported under the preemptive scope of "interest."

REASONS FOR GRANTING THE PETITION

This Court should review and reverse the decision below because (i) it conflicts with a recent decision by the New Jersey Supreme Court on the very same federal issues involving the same practices of the same national bank, *Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94, slip op. (N.J. Nov. 28, 1995) (App. 151-224); (ii) it conflicts with controlling decisions of this Court, including *Tiffany*; (iii) it endorses a form of state supremacy over other states; (iv) it reverses the presumption against preemption; and (v) it has immediate nationwide impact on states, consumers and national banks.

Besides conflicting with *Sherman*,[6] the California court's decision opens the door to limitless preemption of one state's laws by the laws of a sister state. Although the parties agree that the § 85 term "interest" may include a number of different types of charges irrespective of the form or the label, the term cannot be defined to include "all charges" allowed by a bank's home state. In the absence of a firm, federal limit on the meaning of "interest," as required by *Tiffany*, § 85, as interpreted by the lower court, would improperly empower one state to overrule the conflicting public policy decisions of all the other states.

To be sure, "interest" in § 85 may include "damages" paid after a loan default, such as back-end charges to compensate the lender for the time value of its money. Those "damages" that are based on an unpaid balance and measured by time may be interest in the "nature of damages." But contingent sum-certain charges like credit card late fees, attorneys fees, return check fees and over-limit fees are not "interest in the nature of damages" because they are neither based on the unpaid balance nor measured by time. *See Meilink v. Unemployment Resources Comm.*, 314 U.S. 564, 570 (1942) (the distinction that a "penalty is a fixed ad valorem amount taking no account of time, and interest which does depend on time, is persuasive."). These two important features (based on the unpaid balance and measured by time) are prominently identified in the legislative record accompanying the National Bank Act,[7] but were overlooked by the majority below.

[6] In a companion case, the New Jersey Supreme Court also rejected federal preemption with respect to credit card late fees charged by federally insured state banks. *Hunter v. Greenwood Trust Co.*, No. A-103-94, slip op. (N.J. Nov. 28, 1995) (App. 129-150).

[7] *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (Rep. Cole of California: "In California, the interest is by law, where no rate is expressed in the contract, ten percent per annum"); Cong. Globe, 38th Cong., 1st Sess. 1374 (Rep. Kasson of Iowa: "In my own State, sir, we allow a rate of interest of ten percent per annum.").

Although "interest in the nature of damages" may take many forms, for a charge to constitute a "rate" of interest within the meaning of § 85, there must be some connection between the amount of the charge and both the delay time and the unpaid balance. Where a sum-certain default charge is contingent (not required for the loan or forbearance) and is not related to time or the unpaid balance (not a ratio charge), it is a contract penalty rather than "interest in the nature of damages." This Court has often recognized this distinction. *See United States v. Childs*, 266 U.S. 304, 307 (1924) ("[a] penalty is a means of punishment; interest a means of compensation"). At common law, in fact, penalty charges were against public policy and unenforceable. *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 226 (1930) ("But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced"). The decision below conflicts with these common law principles and improperly allows one state's legislative decisions to preempt the contract laws of other states.

A. The California Supreme Court's Decision Conflicts with the New Jersey Supreme Court's Decision on the Very Same Federal Issues.

As noted, the California decision conflicts with the New Jersey Supreme Court's recent decision in *Sherman*, which involved the same practices of the same bank and the same federal preemption issues. (Contrast App. 1-41 with App. 151-190). Disagreeing with the majority opinion of the California court, and citing instead Justice Arabian's dissent, New Jersey's high court declined to define "interest" in § 85 based on South Dakota law. (*See* App. 167). Instead, the New Jersey Supreme Court held

that late fees are not "interest" under the federal statute and that § 85 therefore does not preempt state regulation of late fees. (*See* App. 154).[8]

Because two state supreme courts have decided the same federal issues oppositely, there is a direct and substantial conflict that should be resolved by this Court.[9] In addition, numerous other cases involving the very same issues are pending nationwide and have resulted in additional conflicts.[10] These conflicts cannot be resolved by

[8] In so holding, the New Jersey court specifically criticized the California court's decision. While the California court reasoned that the historical legal usage of "interest" included late fees, the New Jersey court concluded that, in fact, "interest" historically has been limited to a periodic charge expressed as a percentage of the principal balance due. (App. 169). The New Jersey court also disagreed with the California court's assumption that if "interest" did not include late fees a state could discriminate against national banks. Noting that federal law has long prohibited state discrimination against federal instrumentalities, the New Jersey court concluded that "the most-favored lender doctrine serves to eliminate discrimination without distorting or extending the meaning of interest to include charges that Congress neither expressly nor implicitly incorporated in the definition of 'interest.' " (App. 170).

[9] A third state supreme court also has contributed to the conflict. In *Copeland v. MBNA America, N.A.*, No. 94SC409, slip op., 1995 Colo. LEXIS 743 (Colo. Nov. 20, 1995), the Colorado Supreme Court recently appeared to follow the California Supreme Court, holding that Colorado law has been displaced by the law of the bank's home state, in that case, Delaware. Slip op. at 6, 1995 Colo. LEXIS 743 at *5-*6. The Colorado court apparently misunderstood this Court's preemption principles, stating that preemption analysis was not necessary because federal law had only an "incidental" impact on Colorado law. *See id.* slip op. at 5-6, n. 4. Nevertheless, the Colorado court found Colorado law inoperative. *See id.* slip op. at 6.

[10] In Pennsylvania, the intermediate appellate court, like the New Jersey Supreme Court, ruled in favor of the cardholders in two cases, finding no preemption of state law.

any other court and will result in different federal preemption standards for the same practices and the same parties in different parts of the country. This Court should grant certiorari immediately to resolve these and the other conflicts we detail below.

B. The California Supreme Court's Decision Has Wide-Ranging and Dangerous Consequences.

Apart from the conflict between state supreme courts, this case implicates important issues that go beyond the preemption questions typically confronted by this Court. Unlike any other preemption case decided by the Court, this petition challenges a holding that ties the scope of federal preemption directly to the ever-changing legislation of an individual state that is home to a national bank. If, as the California Supreme Court has held, South Dakota has been "entrusted" (App. 30) to define the components of the federal term "interest" in § 85, and not just the arithmetic "rate," then South Dakota's legislative definition of that term has displaced the contract laws of all the other states. Under the ruling below, the breadth of preemption intended by Congress will be determined not by federal law but by state law, so that it may vary from state to state and time to time.

The California Supreme Court in effect has endorsed a radical preemption doctrine unknown to any other

Mazaika v. Bank One, Columbus, N.A., 439 Pa. Super. 95, 653 A.2d 640 (1994) (*en banc*), *alloc. granted*, 659 A.2d 557 (Pa. May 25, 1995); *In re: Citibank (South Dakota) Credit Card Litigation*, 439 Pa. Super. 79, 653 A.2d 39 (1995), *alloc. granted*, 659 A.2d 984 (Pa. May 31, 1995). The Pennsylvania Supreme Court has granted discretionary review in both cases. Also, an appeal concerning many of these same issues has been argued before the United States Court of Appeals for the Third Circuit. *In re Consolidated Credit Card Appeals*, Nos. 94-3203/04, 94-3215/16/17/18 (3d. Cir. appeal pending). Having argued the appeals on February 2, 1995, the parties to that litigation are waiting for the court's decision.

federal statute. By allowing federal preemption to operate "as by a [federal] choice-of-law provision," (App. 30), the lower court has adopted a form of state supremacy over other states unconfined by any federal standards limiting the preemptive actions of the favored states. If a bank's home state authorizes any loan-related fee or term, that authorization will preempt other state laws where the banks are soliciting business. In this way, the California decision has allowed Congress to make the home states of banks supreme to all others.

This is so because the driving force behind the majority opinion is a misconstruction of the "most favored lender" doctrine. Reading that doctrine expansively, the lower court has held in effect that all loan-related charges or terms must be "interest" if they are allowed for other lenders in a bank's home state. Under that analysis, attorneys fees, court costs, foreclosure fees and other default penalties would be federalized "interest" if allowed by a bank's home state. Thus, the home states of banks can preempt countless laws of other states simply by connecting their loan-related authorizations to the "interest" allowed in the home state, as South Dakota has done here.

1. In this respect, the lower court's judgment conflicts with *New York Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671 (1995), where this Court rejected the very type of "package" preemption adopted by the majority below. In *Travelers Ins. Co.*, this Court considered whether certain state surcharge laws that had an "indirect economic effect on the relative costs of various health insurance packages" were related to employee benefit plans so as to be preempted by federal ERISA law. *See id.* at 1679-81. Like Citibank below, the commercial insurers argued that the surcharge laws could impact on the attractiveness of their benefit packages and "preclude a uniform interstate benefit package." *Id.* at 1679. Unlike the California court below, however, this Court categorically rejected those economic package preemption arguments. *Id.* at 1683. As in Justice George's

dissent, this Court observed that even basic state regulation of employment conditions could affect the cost and price of ERISA services. *See id.* at 1679-80. The Court then held that such indirect effects did not give rise to a conflict between state and federal law so as to preempt state law. *Id.* at 1680.

Here, too, the indirect economic effects of state limitations on charges like late fees, return check fees, attorney fees and even court costs do not make those fees "interest" and thereby preempt the laws of a borrower's state. If indirect economic effects were sufficient, the preemptive scope of § 85 would be limitless and entirely dependent on the laws of a bank's home state. But this Court has made clear that federal law, not state law, defines the scope of the term "interest" in § 85.

2. The decision below therefore conflicts as well with this Court's controlling decisions interpreting § 85. In *Haseltine v. Central Bank of Springfield*, 183 U.S. 132 (1901), the Court held that "the definition of usury and the penalties affixed thereto must be determined by the national banking act, and not by the law of the state." *Id.* at 134. Similarly, in *Evans v. National Bank*, 251 U.S. 108 (1919), the Court recognized that both "interest" and "usury" are determined by reference to federal law, stating:

> The maximum interest rate allowed by the Georgia statute is 8 per centum. That marks the limit which a national bank there located may charge upon discounts; but its right to retain so much arises from federal law. The latter also completely defines what constitutes the taking of usury by a national bank, *referring to the state law only to determine the maximum permitted rate.*

Id. at 114 (emphasis added). The holding of the court below implicitly rejects these controlling authorities.[11]

3. This Court should address these conflicts immediately because the California decision endorses a dangerous preemption theory that will impose unwarranted costs and uncertainty on consumers, states, banks and lower courts for years to come. In incorporating South Dakota's definition of interest into § 85, the lower court utterly failed to recognize that Congress has never incorporated state law without limitation into a federal statute so that the state's law would preempt other states' laws. Congress instead has limited incorporation to well-defined areas where the state standard would operate principally if not exclusively within the boundaries of the state itself, not in other states. *See, e.g., United States v. Sharpnack*, 355 U.S. 286 (1958) (addressing Assimilative Crimes Act of 1948, which adopted state law as the federal criminal law for military bases and federal enclaves located in each particular state).

This case is not one in which the incorporation of South Dakota law affects only South Dakota. The California court's ruling that South Dakota has been "entrusted" to define "interest" in § 85 leads to the absurd and unconstitutional result that Congress has authorized South Dakota to legislate federal lending terms for the entire country. The Constitution does not allow Citibank to define federal law with reference to its own state's laws and thereby elevate South Dakota law over the laws

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[11] Quoting *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873), the California Supreme Court observed that " 'Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money or as damages for its detention.' " (App. 18). In *Brown*, however, the detention damages were (i) based on an unpaid balance and (ii) measured by time. No case before 1992 has held that "interest" may include a detention charge that is not based on the unpaid balance and measured by time. Accordingly, *Brown* does not support the conclusion that sum-certain contingent penalties are "interest."

of California and other states. Nor can the states constitutionally enlarge or diminish the scope of federal preemption by redefining the federal term "interest." "To vest the power of determining the extraterritorial effect of a State's own laws and judgments in the State itself risks the very kind of parochial entrenchment on the interests of other States that it was the purpose of the Full Faith and Credit Clause and other provisions of Art. IV of the Constitution to prevent." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

4. The lower court's decision also conflicts with this Court's anti-delegation precedents. Article I, section 1 of the Constitution provides that "[a]ll legislative powers . . . *shall be vested in a Congress* of the United States." U.S. Const. art I, § 1 (emphasis added). If the scope of "interest" in § 85 is determined by the law of a bank's home state, as held below, then Congress's delegation of such legislative authority to South Dakota violates Article I.

This Court's decision in *Panama Refining Co. v. Ryan*, 293 U.S 388 (1935), demonstrates the point. In that case, the Court described the standards for delegating congressional power and struck down a statute that delegated interstate policy-making authority to the President, who then adopted state laws as the operative restrictions. In rejecting the open-ended delegation, the Court focused on the absence of any guidelines limiting the scope or nature of the delegated authority:

> [The statute] does not seek to lay down rules for the guidance of state Legislatures or state officers. It leaves to the states and to their constituted authorities the determination of what production shall be permitted. It does not qualify the President's authority. . . . It establishes no criterion to govern the President's course. It does not require any finding by the President as a condition of his action.

Id. at 415. The Court also found that the context of the statute failed to provide any "standard or rule" against

which the delegated authority could be measured. *Id.* at 418.

Here, delegation to South Dakota of the legislative power to define the federal term "interest" likewise fails. The decision whether "interest" includes liquidated damages, attorneys fees, court costs or other contractual penalties is "quintessentially one of legislative policy" that should be made by Congress, not by an individual state legislature that is unaccountable to the will of the nation. *See Industrial Union Dept. v. American Petroleum Inst.*, 448 U.S. 607, 686 (1980) (Rehnquist J., concurring). Furthermore, neither the word "interest" nor the legislative history of the National Bank Act, as interpreted by the lower court, provides any guidance to the states or to a reviewing court as to the scope of the word or the limits of the delegated discretion. As construed by the lower court, Congress has provided no definition, established no standard, laid down no rule and declared no policy separate from that of the individual states and, therefore, the delegation is unconstitutional.[12] *Panama Refining*, 293 U.S.

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[12] To be sure, *Marquette*, in effect, permits a bank's home state to establish "interest rates" that are controlling in other states. But that result does not amount to a limitless delegation of Congress's lawmaking authority. The federalization of a time-based "*rate*" or required charge for a loan is bounded and checked by the firm, federal definition of "interest" advanced by petitioner but rejected by the majority below. With that definition, it would be easy to determine whether a home state's "rate" comported with the will of Congress. If, however, as the California court has held, South Dakota can broaden the meaning of "interest" so as to determine what credit terms are lawful, then South Dakota would be engaged in lawmaking for the entire nation. As here, South Dakota would be defining not just an arithmetic rate, but also the actual rights and liabilities (*e.g.*, what does "late" mean; are attorneys' fees collectible) affecting citizens of other states. Nothing would stop South Dakota from defining "interest" to include attorneys fees, court costs, foreclosure costs, collection costs or any other loan-related term that

at 430 ("The Congress manifestly is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested"); *Industrial Union*, 448 U.S. at 646 (plurality opinion) (construing statute so as to avoid open-ended delegation of legislative power).[13]

To allow South Dakota to define "interest" in § 85 and, in turn, the preemptive scope of the statute, is to allow that state to substitute its will for the will of Congress. Residents of California and other affected states have no voting opportunity to influence the legislators in South Dakota. Absent accountability, the delegation by Congress inferred by the lower court would constitute a serious violation of the principles embodied in Articles I

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might arguably impact a lender's total return on its loans. Congress could not have intended to delegate its national lawmaking power in such a manner.

[13] Only Congress has open-ended discretion to choose the object and ends of national legislation. *See* L. Tribe, *American Constitutional Law* § 5-17 at 363 (2d ed. 1988). Congress may not authorize individual states to choose between different legislative needs or to substitute the will of a state legislature for that of Congress where such state decisions will have an impact nationally or on residents of other states:

> Congress cannot simply delegate to the states the power to legislate in areas that are reserved to Congress – e.g., powers under the interstate commerce clause – but Congress may by federal legislation adopt and incorporate by reference state laws that already exist or that may exist in the future. For example, *Congress cannot delegate to Illinois the power to legislate federal pollution standards for the whole country. Then Congress would be abdicating interstate commerce control to one state to legislate for the entire nation.*

1 R. Rotunda, J. Nowak, J. Young, *Treatise on Constitutional Law – Substance and Procedure*, § 12.6 at 644(1986) (emphasis added). *See also Yakus v. United States*, 321 U.S. 414, 425-26 (1944).

and IV of the Constitution. *Cf. Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).[14]

Unless § 85 is read with reference to the common law so as to exclude late fees from the definition of "interest," each state could give a different meaning to the term. Each state, by making "interest" mean whatever it wanted, could determine the scope of federal preemption and extend its own lending laws into other states without limit. This Court has recognized that danger before. In *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969), the Court considered whether federal or state law defined the term "branch" in the National Bank Act. The Court stressed that permitting state legislatures to define the federal term "branch" would "make them the sole judges of their own powers," and that Congress "did not intend such an improbable result." *Id.* at 133-34. Here, too, Congress did not intend for South Dakota to define the scope of federal preemption and thereby be the sole judge of its own power. The California Supreme Court's ruling conflicts with these principles and should be reviewed immediately.

C. The California Supreme Court's Decision Flips the Presumption Against Preemption, Misconstrues the Most Favored Lender Doctrine and Improperly Expands the Common Law Definition of "Interest."

1. Besides affecting numerous consumers and the fifty individual states, the California Supreme Court's decision conflicts with even the most basic preemption

[14] In *Florida Lime*, this Court refused to find a California law preempted where residents of that state had no real opportunity to participate in the process that resulted in the federal regulation that allegedly superseded California's law. Here, too, California residents have had no opportunity to participate in the process that has allegedly resulted in South Dakota law preempting California law.

principles. As this Court has held time and again, there is a strong presumption *against* federal preemption of state law. *See Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). As a result of that presumption, " 'the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the *clear and manifest purpose* of Congress.' " *Cipollone v. Liggett Group, Inc.*, 505 U.S. at 516 (plurality opinion) (emphasis added) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Unless a state law "incapacitates the [national] banks from discharging their duties to the government," there will be no preemption. *McClellan v. Chipman*, 164 U.S. 347, 357 (1896).

Here, the California Supreme Court reversed the presumption against preemption. Though recognizing that there were no clear statements in the statute or the legislative history of Congressional intent to preempt state regulation of liquidated damages on revolving credit accounts, the court held that such silence demonstrated Congress's intent to preempt. (*See* App. 24). According to the court below, whenever Congress enacts a federal statute, it intends to preempt state law unless it specifically states otherwise. (*See id.*). That analysis directly conflicts with the standards set forth in *Cipollone*, *McClellan* and dozens of other decisions by this Court.

Contrary to the lower court's decision, *Marquette* does not support an expansive reading of federal preemption principles. *Marquette* established a firm, federal definition of the word "located" in § 85 and held only that a national bank may export its home state's *rate* of interest. *See* 439 U.S. at 313-14. Since South Dakota's definition of the components of interest has nothing to do with the unlimited *rate* at which interest is allowed in that state, *Marquette* provides no basis for exporting South Dakota's definition of interest. Citibank may still charge the unlimited rates allowed by its home state when it solicits consumers in California and other states. It may not, however, impose a separate, sum-certain penalty fee which is neither a "*rate*" based on time and the balance

owed nor "interest." Because California law does not limit the amount of Citibank's "interest rates," but only the form of Citibank's non-interest charges, it does not conflict with § 85.[15]

2. In contrast, the lower court's decision does directly conflict with the common law interpretation of federal statutes mandated by this Court. This Court recently reaffirmed that strong presumption of a common law meaning in *United States v. Texas*, 113 S. Ct. 1631 (1993). In that case, which likewise considered the meaning of "interest" in a federal statute, the Court instructed:

> "[s]tatutes which invade the common law- . . . are to be read with a presumption favoring the retention of long-established and familiar principles". . . . In such cases, Congress does not write upon a clean slate. . . . In order to abrogate a common law principle, the statute must

[15] The majority's decision also incorrectly relies on the observation in *Marquette* that " 'individuals were always free to visit neighboring states and receive credit at foreign interest rates.' " App. 13 and 38, *quoting Marquette*, 439 U.S. at 318. *Marquette* did not suggest, however, that individuals would be required to submit to another state's definition of the federal term "interest" when the borrowers have not even visited the other state or received notice of a definition that conflicts with the ordinary, common sense meaning of "interest." While federal law may provide reasonable notice that the usury ceilings of a borrower's state will not apply in transactions with out-of-state banks, it does not provide notice that fundamental contract, judgment collection and common laws of the borrower's state may also be supplanted by the bank's home state. Without such notice, California consumers who have not visited South Dakota cannot be held to have surrendered the contract rights and protections lawfully enacted by their own elected representatives. "For such Kafkaesque nonsense, We The People will require a new Constitution." *Irwin v. Citibank (South Dakota), N.A.*, 26 Phila. 388, 394 (Phila. Ct. Common Pleas, 1993), *aff'd*, 439 Pa. Super. 79, 653 A.2d 39 (1995), *alloc. granted*, 659 A.2d 984 (Pa. May 31, 1995).

> "speak directly" to the question addressed by the common law.

113 S. Ct. at 1634 (citations omitted); *see also United States v. Shabani*, 115 S. Ct. 382, 384 (1994). The Court also distinguished between interest and penalties (including late fees) and found that penalties are "more onerous than the common law" of prejudgment interest. 113 S. Ct. at 1635-36 ("Unlike the common law, § 3717 also imposes processing fees and penalty charges"). Penalties cannot be "more onerous" than interest if they are one and the same, as the California court incorrectly held below.

The lower court also erroneously assumed that Congress, by its silence, intended to change the common law when it used the word "interest" in § 85. *See id.* at 1634.[16] But because § 85 does not "'speak directly' to the question addressed by the common law," it does not abrogate the common law. *Id.* at 1634. Therefore, Congress must have intended that "interest" in § 85 be construed uniformly based on the ordinary, common law meaning of the term. *See Perrin v. United States*, 444 U.S. 37, 42 (1979).

Congress was fully aware of the ordinary, common law differences between late charges and interest when it

[16] Although the lower court admitted that the common law definition of "interest" excluded penalty charges, it declined to apply a federal definition because the common law cases were not § 85 cases. (App. 32-34 & n.15). That illogical and confused reasoning cannot withstand scrutiny. If Congress does not define a term in a statute or the legislative history, the only other source to determine its meaning is the common law or common understanding. To determine the meaning of a newly enacted statute, a court must refer to analogous cases or sources which necessarily will not have addressed that statute in particular. Hence, the common law is the only guidance courts have in most cases.

passed the National Bank Act in 1864.[17] On at least three occasions before passage of the Act, this Court had already held that sum-certain contingent default charges, like late fees, were not "interest." For example, in *Tayloe v. Sandiford*, 20 U.S. (7 Wheat.) 13 (1822), the Court recognized that "[i]n general, a sum of money in gross, to be paid for the non-performance of an agreement, is considered as a penalty. . . . " *Id.* at 17. Later, in *Lloyd v. Scott*, the Court held:

> If a party agree [sic] to pay a specific sum, exceeding the lawful interest, provided he do [sic] not pay the principal by a day certain, it is not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, *which is considered as a penalty.*

29 U.S. (4 Pet.) at 226 (emphasis added). Likewise, just one year before enactment of the National Bank Act, the Court had stated with respect to any contingent charge:

[17] Even the context of the language demonstrates that Congress understood that "interest" is compensation related to the time value of money. Though § 85 permits a national bank to charge interest at the highest "rate" allowed to any lender in its home state, the statute does not authorize the bank to impose late fees or any type of lending charge other than an interest "rate." In fact, the term "rate" appears in the statute at least nine times, and it always refers to a charge that is related to the passage of time. In contrast, § 86 of the Act provides that where an excessive rate has been charged, the borrower may recover damages in an "amount" equal to twice the interest paid. Unlike the term "rate" in § 85, the term "amount" in § 86 refers to sum-certain damages or penalties that are totally unrelated to the passage of time. *See First Nat'l Bank of Charlotte v. Morgan*, 132 U.S. 141, 144-45 (1889) (§ 86 case where this Court recognized a material difference between compensatory "interest" and deterrent or punitive "penalties").

> The payment of anything additional depends also upon a contingency, and not upon any happening of a certain event, which of itself would be deemed insufficient to make a loan usurious.

Spain v. Hamilton's Adm'r, 68 U.S. (1 Wall.) at 626. Because Congress also was well aware that "[t]he popular or received import of words furnishes the general rule for the interpretation of public laws," *Maillard v. Lawrence*, 57 U.S. (16 How.) 251, 261 (1853), it must have used the term "interest" as it was understood at common law and common understanding to exclude contingent, sum-certain penalties imposed in addition to continuing finance charges.[18]

At common law, "special damages" that more than compensated a lender for the time-value of money were

[18] Contrary to the majority opinion below, ancient and ecclesiastical law also shows that "interest" and sum-certain contract penalties are not the same. At Roman law, the only "interest" that was allowed was that measured by time following a default. In effect, "interesse" (interest) and penalties were the same. But the measure of the "interest" (then called penalty) was based on the unpaid balance and measured by time. Any greater amount was a classic contract penalty ("nomine paenoe") that was "relievable against in equity." *See* R. Comyn, *Treatise on the Law of Usury*, pp. 73-74 & n.(a) (R. Pheney, London 1817); *see also Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986). Today, as in Roman times, "interest" following a loan default is likewise limited and must be measured by the "*id quod interest*" (that which is between) standard. *See Shaw*, 478 U.S. at 315 n.2. Although "interest" for a loan or forbearance is now allowed as well (at Roman times such interest was not lawful), the time measurement for default charges persists. *See id.* If a time measurement is absent, the default charge is a contract penalty or forfeiture because the amount is presumed to exceed the time value of money. *See Meilink*, 314 U.S. at 570; *see also Merchants' Nat'l Bank v. Sevier*, 14 F. 662, 663, 667-75 (C.C.E.D. Ark. 1882) (National Bank Act case surveying the differences between the common law of penalties and statutory usury principles).

prohibited. For example, in *Loudon v. Taxing District*, 104 U.S. (14 Otto) 771 (1881), a borrower defaulted, requiring the lender to sell his own assets at a substantial discount. The lender sued for the "costs" of the default. The issue was whether the borrower was liable for more than the time-value of the lender's money. This Court held that interest measured by time is the *only* damage allowed:

> *[A]ll damages for delay* in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

Id. at 774 (emphasis added). *See also New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (a party "cannot recover special damages for the detention of money due to him beyond what the law allows as interest").

The majority below turned the reasoning of this common law upside down. Instead of holding that "interest" based on the unpaid balance and the passage of time is the "measure of all such damages," the California court found that additional, sum-certain "penalties" are the measure of all "interest." That holding completely disregards the guidelines established by this Court in *United States v. Texas, Tayloe, Lloyd, Spain, Loudon* and *Piaggio*.

The California Supreme Court erred in holding that sum-certain contingent late fees imposed in addition to continuing finance charges are "interest" under § 85. Because that court's error adversely affects so many consumers and allows South Dakota's definition of "interest" to preempt all the other states' consumer protection laws, this Court should grant certiorari and correct the error.

D. The Court Should Review This Case to Provide Much Needed Guidance to States, Banks, Consumers and the Lower Courts.

The question of whether "interest" in § 85 can be defined by state law to include contract penalties is one of national importance to consumers, each of the states, and the national banks throughout the country. Back in 1992, Massachusetts and twenty-seven states asked this Court to review almost the exact same issues and to reverse a lower court decision finding preemption in *Massachusetts v. Greenwood Trust Co.*, 113 S. Ct. 974 (1993) (denying certiorari).[19] Though the Court declined to review the matter at that time, the controversy has not gone away. In fact, as already described, litigation is now pending nationwide.

The sheer number of cases as well as the conflicting opinions demonstrate the national significance of the issues and the urgent need for guidance from this Court. Until the Court decides the questions raised here, the controversy will continue, draining the pockets of consumers and litigants and the resources of the courts. To attract major credit card operations, state legislators will continue their race to the bottom in consumer protection by defining "interest" to embrace countless fees, including court costs and even attorneys fees. National banks located in those states will continue to export the contract penalties in violation of other states' laws, and consumers will continue to suffer from the unlawful practice.

Just as these issues have been deemed appropriate for review by four state supreme courts during the past year, they are even better suited for review by this Court.

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[19] The only difference was that the *Greenwood* case involved the definition of "interest" in § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), 12 U.S.C. § 1831d ("§ 521"). Section 521, modeled after § 85, applies to federally insured state banks instead of national banks.

Where, as here, there are unsettled issues of federal and constitutional law causing grave concern and expense to every state and to consumers nationwide, no individual state supreme court should have the last word. Because this case presents important and urgent questions of federal law, this Court should grant certiorari and decide the issues.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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No. ________

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

Petition For A Writ Of Certiorari To The California Supreme Court

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

TABLE OF APPENDIX

Filed 9/1/95 Banks and Bankruptcy

IN THE SUPREME COURT OF CALIFORNIA

BARBARA SMILEY,	)	
Plaintiff and Appellant,	)	S041711
v.	)	Ct.App. 2/7 No. B078913
CITIBANK (SOUTH DAKOTA), N.A.,	)	L.A. Super. Ct. No. BC059202
Defendant and Respondent.	)	

We granted review in this cause – which is one of numerous similar matters brought in federal and state courts throughout the nation – in order to consider the meaning and effect of section 30 of the National Bank Act of 1864. In pertinent part and without substantive change, the provision has been incorporated in section 5197 of the Revised Statutes of 1878, and has been codified in section 85 of title 12 of the United States Code (hereafter section 85), which is its common designation. As relevant here, it provides that a national banking association, or more simply a national bank, "may take, receive, reserve, and charge on any loan . . . *interest* at the rate allowed by the laws of the State . . . where the bank is located. . . . " (Italics added.) Our question is, "May the term 'interest' be construed to cover late payment fees?" Our answer is, "Yes, if such fees are allowed by a national bank's home state."

I

Plaintiff Barbara Smiley (hereafter Smiley) filed a complaint in the Superior Court of Los Angeles County against defendant Citibank (South Dakota), N.A. (hereafter Citibank). Smiley purported to proceed on behalf of herself and all others similarly situated – specifically, the class of persons "who held or currently hold a Citibank credit card . . . while they were residents of California and while they maintained a California billing address, and who have contracted for or been charged a late charge on such credit card account." She alleged facts to the following effect: she was a resident of Los Angeles County; Citibank was a national bank chartered by the Comptroller of the Currency with its only address in Sioux Falls, South Dakota, and consequently located solely in that state; it issued credit cards under the "Visa" and "MasterCard" service marks; she held a Citibank "Preferred" Visa credit card and had held a Citibank Master Card credit card; as a condition of the extension of credit, Citibank "charges a late charge of up to $15.00 upon California consumers who use its credit cards, irrespective of the outstanding balance or amount owing on the credit card in question," when they do not timely make a minimum payment; she had been charged late payment fees by Citibank on both her Preferred Visa and her MasterCard credit card accounts. On the basis of such allegations, she attempted to state various causes of actions arising under California law, including statutes and common law, going ultimately to the amount of the late payment fees in question, and sought various forms of relief.

Citibank filed in the United States District Court for the Central District of California a notice of removal of Smiley's action from state court to federal – its petition for removal. The sole ground on which it relied was diversity of citizenship – so-called "diversity jurisdiction" – under subdivision (a)(1) of section 1332 of title 28 of the United States Code, which requires not only that the parties are "citizens of different states" but also that the "matter in controversy exceeds the sum or value of $50,000. . . . "

Subsequently, Citibank filed an answer in federal district court. One of the affirmative defenses was to the effect that Smiley's complaint failed to state facts sufficient to constitute a cause of action against Citibank; Smiley's pleading, which was based on California law bearing on the amount of late payment fees, was without support because that law was preempted as to Citibank through section 85 by operation of the supremacy clause.

Smiley then filed in federal district court a motion to remand the action to the superior court. Her ground was that diversity jurisdiction was lacking because, properly considered, the matter in controversy did not exceed $50,000.

Citibank in turn filed in federal district court a motion requesting leave to amend its petition for removal. It sought to add as a ground that the action, as a result of preemption, arose "under the Constitution, treaties or laws of the United States" – so-called "federal question jurisdiction" – under subdivision (b) of section 1441 of title 28 of the United States Code.

In due course, the federal district court filed an order denying Citibank's motion requesting leave to amend its petition for removal and granting Smiley's motion to remand. (*Smiley v. Citibank (South Dakota), N.A.* (C.D.Cal. 1993) 863 F.Supp. 1156). It denied Citibank's motion as untimely, although it noted that, "[g]iven the strength of Citibank's preemption argument and the strong public interest in developing a uniform and consistent body of federal banking law, [it] understands Citibank's desire to adjudicate this dispute in federal court." (*Id.* at p. 1162). It granted Smiley's motion, accepting as meritorious her claim that diversity jurisdiction was lacking because, properly considered, the matter in controversy did not exceed $50,000.

Citibank then filed in the superior court a common law motion for judgment on the pleadings. Its ground was to the effect that Smiley's complaint failed to state facts sufficient to constitute a cause of action against it as a result of preemption through section 85. Smiley filed opposition. By leave of the court, the United States filed a statement of interest on behalf of the Comptroller of the Currency as amicus curiae in support of Citibank's position.

The superior court caused entry of a minute order wherein it denied Citibank's motion.

Citibank proceeded to file a petition for writ of mandate in the Court of Appeal, Second Appellate District, seeking to compel the superior court to vacate its order denying its motion and to enter a new and different order granting its request.

After soliciting and receiving opposition from Smiley, the Court of Appeal caused issuance of an alternate writ of mandate, compelling the superior court either to vacate its earlier order denying Citibank's motion and to grant its request or to show cause why, among other things, it should not be required to do so by peremptory writ.

Complying with the Court of Appeal's alternative writ of mandate, the superior court caused entry of a minute order. In that order, it vacated its earlier order denying Citibank's motion and proceeded to grant its request.

Thereupon, Smiley filed a notice of appeal in the superior court. That same day, the Court of Appeal discharged the alternative writ of mandate and dismissed Citibank's petition as moot.

Subsequently, the superior court filed an order, with reasons stated, granting Citibank's motion, and in accordance therewith filed a judgment of dismissal.

On appeal, the Court of Appeal affirmed.[1] Agreeing with the superior court on preemption through section 85, a majority of two justices concluded that its order granting Citibank's motion should be sustained. Disagreeing, a single dissenting justice would have held to

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[1] The Court of Appeal impliedly treated Smiley's appeal as taken from the superior court's judgment – which was appealable (see *Campbell v. Jewish Com. for P. Service* (1954) 125 Cal.App.2d 771, 773 (per Peters, P.J.)) – and not from its order granting Citibank's motion – which was not (*ibid.*).

the contrary. The majority relied in large part on *Greenwood Trust Co. v. Com. of Mass.* (1st Cir. 1992) 971 F.2d 818 (hereafter sometimes *Greenwood Trust*), which construes section 85 in the course of construing a provision evidently modeled on its language, viz., section 521 of the Depository Institutions and Monetary Control Act of 1980 (hereafter DIDA), codified in subsection (a) of section 1831d of title 12 of the United States Code, which covers federally-insured state banks and federally-insured branches of foreign banks. They also relied on the position taken by the Comptroller of the Currency. For his part, the dissenter criticized the *Greenwood Trust* court's reasoning and the Comptroller of the Currency's views, the former at length and in detail and the latter less so.

On Smiley's petition, we granted review. We now affirm.

II

Smiley's sole contention is that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings.[2]

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[2] Citibank requests us to take judicial notice of matter reflected in several items, comprising the following: certain decisions of federal, sister-state, and English courts; certain documents from the Office of the Comptroller of the Currency and other federal administrative agencies; certain submissions filed in the courts of California and a sister state by the United States on behalf of the Comptroller of the Currency; and certain documents from Citibank relating to the terms of its "Preferred" credit card accounts in the general period pertinent here. We do

A

In ruling on a common law motion for judgment on the pleadings made by a defendant, a trial court determines

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so. We are either required or permitted to take judicial notice (Evid. Code, § 459, subd. (a)) with respect to all such matter. Specifically, we are required to take judicial notice of decisions constituting the law of the United States. (*Id.*, § 451, subd. (a).) We are permitted to take judicial notice of the following: decisions constituting the law of any state of the United States (*id.*, § 452, subd. (a)); the law of any foreign nation (*id.*, § 452, subd. (f)); official acts of the executive departments of the United States (*id.*, § 452, subd. (c)); records of any court of record of any state of the United States (*id.*, § 452, subd. (d)); and "[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy" (*id.*, § 452, subd. (h)). Smiley argues against judicial notice of some of the matter in question, but does to unpersuasively.

In conjunction with a brief filed as amicus curiae supporting Citibank's position, Chase Manhattan Bank, N.A., requests us to take judicial notice of matter reflected in several items, comprising certain decisions of sister-state courts and certain documents from federal administrative agencies. We do so. As stated above, we are permitted to take judicial notice with respect to all such matter.

Smiley effectively moves us to strike a brief filed by the Comptroller of the Currency as amicus curiae supporting Citibank's position. She argues that, by appearing under his own name, the Comptroller has acted outside his authority under the laws of the United States, He has not. (12 U.S.C. § 93(d) [*sic:* the subsection should be designated "(e)"].) Accordingly, we deny her request.

We note in passing that, during the course of this action, section 438 was added to the Code of Civil Procedure dealing with motions for judgment on the pleadings, and section 4001 was added to the Financial Code dealing with late payment fees in consumer credit agreements. Neither Smiley nor Citibank has

what has been called a pure question of law (*Donohue v. State of California* (1986) 178 Cal.App.3d 795, 802; *Goodley v. Wank & Wank, Inc.* (1976) 62 Cal.App.3d 389, 392-393), but what is in fact a mixed question of law and fact that is predominantly legal: Does the plaintiff's complaint state facts sufficient to constitute a cause of action against the defendant? (*Donohue v. State of California, supra,* 178 Cal.App.3d at p. 802; *Goodley v. Wank & Wank, Inc., supra,* 62 Cal.App.3d at pp. 392-393.) In so doing, the trial court generally confines itself to the complaint and accepts as true all material facts alleged therein. (E.g., *Colberg, Inc. v. State of California* ex rel. *Dept. Pub. Wks.* (1967) 67 Cal.2d 408, 412.) As appropriate, however, it may extend its consideration to matters that are subject to judicial notice. (E.g., *ibid.*) In this, it performs essentially the same task that it would undertake in ruling on a general demurrer. That is not surprising. A common law motion for judgment on the pleadings "ha[s] the purpose and effect of a general demurrer." (*Kortmeyer v. California Ins. Guarantee Assn.* (1992) 9 Cal.App.4th 1285, 1293; see *Colberg, Inc. v. State of California* ex rel. *Dept. Pub. Wks., supra,* 67 Cal.2d at pp. 411-412.)

An appellate court independently reviews a trial court's order on such a motion. (See *Lumbermens Mut. Cas. Co. v. Vaughan* (1988) 199 Cal.App.3d 171, 178-179; *Crain v. Electronic Memories & Magnetics Corp.* (1975) 50 Cal.App.3d 509, 512; cf. 1 Childress & Davis, Federal Standards of Review (2d ed. 1992) § 5.01, p. 5-6 [stating that a federal district court's order on the analogous motion for judgment on the pleadings under rule 12(c) of the Federal Rules of Civil Procedure is subject to "review . . . de novo"].) That is certainly proper. Independent review is called for when the underlying determination involves a purely legal question or a predominantly legal mixed question. (E.g., *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 888.) As stated, the determination here is such.

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raised any claim that either provision is pertinent to the conduct of the proceedings or to the outcome thereof.

We also note in passing that Smiley asserts that the superior court's order, with reasons stated, granting Citibank's common law motion for judgment on the pleadings is "not reflective of the actual proceedings or pleadings in the case." So far as appears, it is.

Finally, we as the court of last resort independently review a decision by a lower appellate court concerning a trial court's order on a motion of this sort. Indeed, we so review *all* such decisions. We have no need to defer, because we can ourselves conduct the same analysis. In fact, we have need *not* to defer, in order to be free to further the uniform articulation and application of the law within our jurisdiction.

B

The question that is central to our analysis involves section 85 – which, as stated above, provides that a national bank "may take, receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located" – and the preemption of California law. It is clear that national banks are authorized to conduct credit card programs, to issue credit cards to holders, and to provide money thereunder to such persons and to others on their behalf in exchange for

goods or services. (12 C.F.R. § 7.7378 (1995); see 12 U.S.C. § 24 (Seventh) [authorizing national banks to "loan[] money on personal security"].) it is also clear that, in thus providing money under credit cards, a national bank makes "loans" within the meaning of section 85.

As to preemption generally, the law is as follows:

The supremacy clause declares, in pertinent part, that "Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." (U.S. Const., art. VI, cl. 2.)

Since the decision in *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316, 427, "it has been settled that state law that conflicts with federal law is 'without effect.' " (*Cipollone v. Liggett Group, Inc.* (1992) ___ U.S. ___, ___ [112 S.Ct. 2608, 2617].)

Whether federal law preempts state law "fundamentally is a question of congressional intent. . . . " (*English v. General Electric Co.* (1990) 496 U.S. 72, 79; accord, *Cipollone v. Liggett Group, Inc., supra,* ___ U.S. at p. ___ [112 S.Ct. at p. 2617]; *Mangini v. R.J. Reynolds Tobacco Co.* (1994) 7 Cal.4th 1057, 1066; see, e.g., *N.Y. Conference of Blue Cross v. Travelers Ins.* (1995) ___ U.S. ___, ___-___ [115 S.Ct. 1671, 1676-1677].)

Such preemption is found in "three circumstances." (*English v. General Electric Co., supra,* 496 U.S. at p. 78.) "First, Congress can define explicitly the extent to which its enactments pre-empt state law." (*Ibid.;* accord, *Cipollone v. Liggett Group, Inc., supra,* ___ U.S. at p. ___ [112

S.Ct. at p. 2617].) "Second, in the absence of explicit statutory language, state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively." (*English v. General Electric Co., supra,* 496 U.S. at p. 79; accord, *Cipollone v. Liggett Group, Inc., supra,* ___ U.S. at p. ___ [112 S.Ct. at p. 2617].) "Finally, state law is pre-empted to the extent that it actually conflicts with federal law." (*English v. General Electric Co., supra,* 496 U.S. at p. 79; accord, *Cipollone v. Liggett Group, Inc., supra,* ___ U.S. at p. ___ [112 S.Ct. at p. 2617].)[3]

"Consideration of issues arising under the Supremacy Clause 'start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress.' " (*Cipollone v. Liggett Group, Inc., supra,* ___ U.S at p. ___ [112 S.Ct. at p. 2617].) That appears to be true of preemption generally. (See *ibid.*) It it certainly true of "field preemption" specifically. (*English v. General Electric Co., supra,* 496 U.S. at p. 79.) The " 'historic police powers of the States' " extend to consumer protection. (E.g., *California v. ARC America Corp.* (1989) 490 U.S. 93, 101.) They extend as well to banking.

[3] The "three categories" of preemption referred to in the text should not be taken to be "rigidly distinct. Indeed, field pre-emption may be understood as a species of conflict pre-emption: A state law that falls within a pre-empted field conflicts with Congress' intent (either express or plainly implied) to exclude state regulation." (*English v. General Electric Co., supra,* 496 U.S. at pp. 79-80, fn. 5; accord, *Gade v. National Solid wastes Management Ass'n* (1992) ___ U.S. ___, ___, fn. 2 [112 S.Ct. 2374, 2386, fn. 2].)

(See *National State Bank, Elizabeth, N.J. v. Long* (3d Cir. 1980) 630 F.2d 981, 985-986; cf. *Lewis v. BT Investment Managers, Inc.* (1980) 447 U.S. 27, 38 [under the commerce clause: "both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern"].) It must be recognized, however, that federal authority has also affected banking since before enactment of the National Bank Act in 1864. (*National State Bank, Elizabeth, N.J. v. Long, supra,* 630 F.2d at p. 985.)[4]

Turning to the case at bar, we must be precise concerning the question of preemption.

The issue is not the *existence* of preemption under section 85. In *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299 (hereafter sometimes *Marquette*), which happens to have concerned credit card programs at national banks, the United States Supreme Court held that section 85 does in fact preempt state law within its coverage, apparently under the rubric of "conflict preemption." Looking to section 30 of the National Bank Act, the source of section 85, the *Marquette* court held that the latter authorizes a national bank to demand and collect interest on any loan, even an interstate loan, at the rate

[4] In his dissenting opinion, Justice Arabian takes the position that the standard for preemption applicable here "requires the invalidation of a state law *only* where it ' "incapacitates the [national] banks from discharging their duties to the government. . . . " ' " (Dis. opn. of Arabian, J., *post,* at p. ___ [typed dis. opn. of Arabian, J., at p. 16], italics in original.) That is not the ease. For his test, he quotes *McClellan v. Chipman* (1896) 164 U.S. 347, 357. A century of law, however, has intervened. (See fn. 5, *post.*)

permitted under its home state's law – even an unlimited rate (*Hiatt v. San Francisco National Bank* (9th Cir. 1966) 361 F.2d 504, 506-507; see *Daggs v. Phoenix National Bank* (1900) 177 U.S. 549, 555-556 [dealing with section 30 of the National Bank Act]) – notwithstanding the law of any other state. (*Marquette Nat. Bank v. First of Omaha Corp., supra,* 439 U.S. at pp. 307-319.) In short, it concluded that the provision empowers such a bank to "export" its home state's interest rate In reaching its result, it addressed an argument that the " 'exportaiton' of interest rates . . . will significantly impair the ability of States to enact effective usury laws. This impairment, however, has always been implicit in the structure of the National Bank Act, since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates. [Citation.] This impairment may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards. But the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court." (*Id.* at pp. 318-319, fn. omitted.) In so many words, the *Marquette* court read section 85 as a choice-of-law provision, fixing the law of the national bank's home state relative to interest rates as the rule governing all loans, even interstate loans, notwithstanding the law of any other state. Section 85 thereby entrusts the question of the lawfulness of a national bank's interest rates to its home state and to its home state alone.[5]

[5] We note in passing that, in its preemption analysis, *Marquette* says not a word about whether section 85 " 'incapacitates

The issue, to return to our theme, is not the *existence* of preemption under section 85, but rather its *scope*. Its resolution will depend on the meaning that the term "interest" bears within the provision.

We cannot find the meaning of the term "interest" in section 85 itself. The provision simply does not define the word. (E.g., *Ament v. PNC Nat. Bank* (W.D.Pa. 1994) 849 F.Supp. 1015, 1019; *Watson v. First Union Nat. Bank of South Carolina* (D.S.C. 1993) 837 F.Supp. 146, 150; *Goehl v. Mellon Bank (DE)* (E.D.Pa. 1993) 825 F.Supp. 1239, 1241; *Nelson v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 794 F.Supp. 312, 317.)

Let us then proceed to consider the source of section 85, which is section 30 of the National Bank Act.

What we now call the National Bank Act was passed by Congress in 1864, in the midst of the Civil War, under the title, "An Act to provide a National Currency, secured by a Pledge of United States Bonds, and to provide for the Circulation and Redemption thereof." (Act of June 3, 1864, ch. 106, 13 Stat. 99.) It substantially repealed (*id.*, ch. 106, § 62, 13 Stat. 118) and superseded (*Id.*, ch. 106, §§ 1-61, 63-64, 13 Stat. 99-118) a statute enacted in 1863, under the title, "An Act to provide a national Currency, secured by a Pledge of United States Stocks, and to provide for the Circulation and Redemption thereof" (Act of Feb. 25, 1863, ch. 58, 12 Stat. 665). Its title was altered in

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the [national] banks from discharging their duties to the government' " (*McClellan v. Chipman, supra*, 164 U.S. at p. 357, quoting *National Bank v. Commonwealth* (1869) 76 U.S. (9 Wall.) 353, 362) – as it plainly does not. *Marquette* thus precludes Justice Arabian's standard for preemption. (See fn. 4, *ante*.)

1874 to "the national-bank act." (Act of June 20, 1874, ch. 343, § 1, 18 Stat. 123.)

In *Marquette*, the United States Supreme Court declared that the purpose of the National Bank Act was "to facilitate . . . a 'national banking system[]' " (*Marquette Nat. Bank v. First of Omaha Corp., supra*, 439 U.S. at p. 315) – "in part," as it had earlier stated in *Tiffany v. National Bank of Missouri* (1873) 85 U.S. (18 Wall.) 409, 413 (hereafter sometimes *Tiffany*), to "provid[e] a currency for the whole country, and in part to create a market for the loans of the General government." Within this system, "[n]ational banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." (*Davis v. Elmira Savings Bank* (1896) 161 U.S. 275, 283; accord, *Farmers', etc. Nat. Bank v. Dearing* (1875) 91 U.S. (1 Otto) 29, 33-34.)

In *Tiffany*, the United States Supreme Court declared that the purpose of section 30 of the National Bank Act, as it later stated in *Marquette*, was to grant national banks " 'most favored lender' status" in their home states. (*Marquette Nat. Bank v. First of Omaha Corp., supra*, 439 U.S. at p. 314, fn. 26.) In *Tiffany's* words, the provision "was intended to give [national banks] a firm footing in the different States where they might be located. It was expected they would come into competition with State banks" – and others – "and it was intended to give them at least equal advantages in such competition." (*Tiffany v. National Bank of Missouri, supra*, 85 U.S. (18 Wall.) at p. 412.) "Most favored lender" status "was considered indispensable to protect them against possible unfriendly State

legislation. Obviously, if State statutes should allow to their banks . . . a rate of interest greater than the ordinary rate allowed to natural persons, National banking associations could not compete with them, unless allowed the same. On the other hand, if such associations were restricted to the rates allowed by the statutes of the State to banks which might be authorized by the State laws, unfriendly legislation might make their existence in the State impossible. A rate of interest might be prescribed so low that banking could not be carried on, except at a certain loss. The only mode of guarding against such contingencies was that which, we think, Congress adopted. It was to allow to National associations the [highest] rate allowed by the State. . . . This construction accords with the purpose of Congress, and carries it out. It accords with the spirit of all the legislation of Congress. National banks have been National favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States, or to ruinous competition with State banks" – or others. (*Id.* at pp. 412-413.) "In harmony with this policy is the construction we think should be given to the thirtieth section of the act of Congress we have been considering. It gives advantages to National banks over their State competitors. It allows such banks to charge such interest as" what was later called the state's "most favored lender." (*Id.* at p. 413.) Thus, the purpose of section 30 of the National Bank Act was to grant national banks "most favored lender" status in their home states – to protect them from

possible unfriendly state legislation, whether such legislation was unfriendly in intent or effect. "The mechanism of referring to state law" – to take words written in a different context but nevertheless fitting here – "is simply one designed to implement that . . . intent and build into the federal statutes a self-executing provision to accommodate to changes in state regulation." (*First National Bank v. Dickinson* (1969) 396 U.S. 122, 133.)[6]

With this in mind, we can undertake to construe the term "interest" in section 30 of the National Bank Act.

Looking at the National Bank Act itself, we find no express definition of the term "interest" in section 30. The provision itself does not offer a meaning. Neither does any other.

Surveying the National Bank Act within its context, we discover a basis for inferring an implied definition of the term "interest" in section 30.

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[6] In *Marquette,* the United States Supreme Court noted that the " 'most favored lender' status for national banks under *Tiffany* has since been incorporated into the regulations of the Comptroller of the Currency." (*Marquette Nat. Bank v. First of Omaha Corp., supra,* 439 U.S. at p. 314, fn. 26.) See subsection (a) of section 7.7310 of title 12 of the Code of Federal Regulations (1995): "A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company or morris plan bank, without being so licensed."

Around the time of the passage of the National Bank Act, according to one definition then current in American legal usage, "interest" was a "sum of money paid or allowed by way of compensation for the loan or use of another sum. . . . " (2 Burrill, A New Law Dictionary and Glossary (1851) p. 629, col. 1.) According to another such definition, "interest" was the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use." (1 Bouvier, A Law Dictionary (10th ed. 1860) p. 652, col. 1.) As subsequently restated by the United States Supreme Court: "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention. . . . " (*Brown v. Hiatts* (1872) 82 U.S. (15 Wall.) 177, 185.) This was the word's "plain meaning" (dis. opn. of Arabian, J., *post*, at p. ___ [typed dis. opn. of Arabian, J., at p. 6]) and "ordinary and commonly understood sense" (dis. opn. of George, J., *post*, at p. ___ [typed dis. opn. of George, J., at p. 3]).[7]

[7] In English legal usage, from which the American derived, the term "interest" carried substantially the same broad meaning as indicated in the text. Thus, in *Arnott v. Redfern* (1826 C.P.) 130 Eng.Rep. 549, 551-552, the court declared: "[I]t appears there are two principles on which interest is given in our courts: first, where the intent of the parties that interest should be paid, is to be collected from the terms or nature of the contract; secondly, where the debt has been wrongfully detained from the creditor."

Compare 7 Oxford English Dictionary (2d ed. 1989) pages 1099 to 1100: In medieval Latin, "*interesse* (Interest) differed from *usura* (Usury) in that the latter was avowedly a charge for the use of money, which was forbidden by the Canon Law; whereas originally '*interesse* refers to the compensation which under the Roman Law, was due by the debtor who had made default. The measure of compensation was *id quod interest*, the difference between the creditor's position in consequence of the debtor's laches and the position which might reasonably have been anticipated as the direct consequence of the debtor's fulfillment of his obligation'." (Accord, *Library of Congress v. Shaw* (1986) 478 U.S. 310, 315, fn. 2 ["The institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan. [Citation.] The measure of the penalty due for the default or delay was *id quod interest* – that which is between – the difference between the creditor's current position and what it would have been if the loan had been timely and fully repaid."].)

In his dissenting opinion, Justice George ignores the broad meaning of the term "interest" in American legal usage around the time of the passage of the National Bank Act. This is not surprising in view of the fact that, with the singular exception of *Greenwood Trust*, he fails to cite any of the scores of decisions and other authorities bearing directly on the question before the court.

Thus, the term "interest" readily embraced a periodic charge based on a percentage of a certain sum, either the amount lent or some other, payable absolutely by maturity.

But the word was not so limited. As reported decisions demonstrate, it could include as well a late payment fee, payable contingently in the event of default after maturity. Such a fee could be calculated as a periodic percentage charge. (See *Wilkinson v. Daniels* (Iowa 1848) 1 Greene 179, 188; see generally Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious (1933) 82 A.L.R. 1213, 1214-1223 [collecting pre- and post-National Bank Act decisions].) It could also be fixed as a flat fee. (See *Craig v. Pleiss* (1856) 26 Pa. 271, 271-272, 272-274; *Wernwag et al. v. Mothershead et al.* (Ind.

1834) 3 Blackford 401, 401-402; see generally Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. at pp. 1214-1223 [collecting pre- and post-National Bank Act decisions].)[8]

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[8] Even if used in conjunction with "rate," the term "interest" – contrary to what Justice Arabian implies in his dissenting opinion – was not limited to a periodic percentage charge, whether or not payable absolutely by maturity. (See *Wernwag et al. v. Mothershead et al., supra*, 3 Blackford at pp. 401-402.) Thus, it was stated that a "promissory note . . . , on default of payment when due, drew interest at the rate specified in the note from the time it became due," to wit, " 'five dollars interest per week until paid.' " (*Ibid.*)

In his dissenting opinion, Justice George effectively asserts that the term "interest" could not include a late payment fee or indeed any other contingent charge. That is not so. *Lloyd v. Scott* (1830) 29 U.S. (4 Pet.) 205, on which he relies, does *not* define "interest" to exclude a late payment fee. It merely states that such a fee, "exceeding the *lawful* interest, . . . is not usury," i.e., *unlawful* interest, if avoidable by timely payment. (*Id.* at p. 226, italics added.) Similarly, *Spain v. Hamilton's Administrator* (1863) 68 U.S. (1 Wall.) 604, on which he also relies, does *not* define "interest" to exclude a contingent charge. It merely states that such a charge "of itself would be deemed insufficient to make a loan usurious," i.e., bearing *unlawful* interest. (*Id.* at p. 626.) Finally, Annotation, Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. 1213, on which he relies as well, all but expressly defines "interest" to include a late payment fee. As it declares in its title, the annotation deals with "interest after maturity." (*Id.* at p. 1213.) By tautology, "interest after maturity" is interest; by convention, "interest *after maturity*" is a late payment fee. Furthermore, the annotation states, as the "general rule," that "a provision in a note or other contract for the payment of money, by which the debtor agrees to pay after maturity interest at a higher rate than permitted by the usury laws, or a sum of money which will exceed that rate, does not render the note or other contract usurious, if the parties in making the contract act in good faith, without intent of evading the usury law." (*Id.* at p. 1214.) That means that a late payment fee is indeed *interest* – and is generally *lawful* interest. In view of the foregoing, we are able to see through the assertion that a late payment fee "would *not* be considered interest for the purpose of determining whether the loan exceeded the legally permitted rate of interest." (Dis. opn. of George, J., *post*, at p. ___ [typed dis. opn. of George, J., at p. 5], italics in original.) The quoted language is an attempt, ultimately unsuccessful, to veil over the fact that such a fee was generally considered lawful interest.

In his dissenting opinion, Justice Arabian effectively asserts that the term "interest" did not include a late payment fee. In doing so, he merely begs the question, simply and repeatedly labeling such a fee a "*non*-interest-rate . . . term[ ]." (Dis. opn. of Arabian, J., *post*, at p. ___ [typed dis. opn. of Arabian, J., at p. 1], italics in original; accord, *id.* at pp. ___, ___, ___, ___ & ___ [typed dis. opn. of Arabrian, J., at pp. 3, 7, 12, 13, & 15].) We need not respond.

In view of the foregoing, we believe that the term "interest" in section 30 of the National Bank Act should be construed to cover late payment fees, if such fees are allowed by a national bank's home state. Recall the definition of "interest" as a "sum of money paid or allowed by way of compensation for the loan or use of another sum" (2 Burrill, A New Law Dictionary and Glossary, *supra*, p. 629, col. 1) or the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use" (1 Bouvier, A Law Dictionary, *supra*, p. 652, col. 1). Such language easily encompasses late payment fees, as compensation for use of money, specifically, its retention, beyond the loan's term. Also recall the cited case law. It confirms the conclusion. Lastly, recall the statutory context. If "interest" were not read as indicated above, the purpose of facilitating a national

banking system by granting national banks "most favored lender" status in their home states could be frustrated by unfriendly state legislation. Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks,* but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks,* at a level high enough that *they* could lend at a profit. Such a result would be untenable.[9]

[9] In their separate dissenting opinions, Justice Arabian and Justice George suggest that Congress had no need to protect national banks through the "most favored lender" doctrine under section 30 of the National Bank Act insofar as late payment fees were concerned. To quote Justice George: "It has been quite well settled, since the early 1800's, that – even in the absence of a specific federal statutory prohibition – a state may *not* discriminate against a 'federal instrumentality' either in the enactment or the enforcement of state laws, and a national bank, of course, is a federal instrumentality." (Dis. opn. of George, J., *post,* at p. ___ [typed dis. opn. of George, J., at p. 7], italics in original; accord, dis. opn. of Arabian, J., *post,* pp. ___-___ [typed dis. opn. of Arabrian, J., at pp. 11-12].) By the same reasoning, Congress had no need to protect national banks at all. In *Tiffany,* however, the United States Supreme Court concluded that Congress had *in fact* provided them protection, whether it *needed* to do so or not. We are bound thereby.

In his dissenting opinion, Justice Arabian attempts to deconstruct the "most favored lender" doctrine, transforming it from a rule to protect national banks in their home states from possible unfriendly state legislation into a mechanism to prevent states from abolishing banking as an institution. He fails in his endeavor. He cannot overcome Senator Sherman, who, as the sponsor in the Senate of the bill that would become the National Bank Act, urged "most favored lender" status for national banks. (See Cong. Globe, 38th Cong., 1st Sess., p. 2126 (1864).) Neither can he overcome the *Tiffany* court, which articulated the doctrine as here presented not long afterwards. Lastly, he cannot overcome the *Marquette* court, which reaffirmed the doctrine in the same form a century later. It may be noted in passing that the words of *Tiffany* on which he relies reflect a purpose not to prevent states from abolishing banking as an institution but, as explained in the text, to protect national banks in their home states from possible unfriendly state legislation, whether such legislation was unfriendly in intent or effect.

This is not to suggest that, in using the term "interest" in section 30 of the National Bank Act, Congress did not employ the word in the sense of a periodic percentage charge payable absolutely by maturity. It evidently did. (See, e.g., Cong. Globe, 38th Cong., 1st Sess., *supra,* pp. 1373-1376, 2123-2128.)

But it is to state that, in doing so, Congress did *not* employ the word *only* in that sense. Certainly, "rate" was not tied exclusively to that sense. (See fn. 8, *ante;* see also *Sherman v. Citibank (South Dakota)* (N.J. Super. Ct. App. Div. 1994) 272 N.J.Super. 435, 447, cert. granted (1994) 138 N.J. 270 [stating that "[w]hile interest rate . . . has been defined as the numerical percentage rate of interest, . . . the phrase need not be read so restrictively when construed in its statutory and historical context"].) By the time of the National Bank Act, banking had begun to change rapidly and radically. (See 2 Redlich, The Molding of American Banking (1951) pp. 85-98.) So too, governmental responses to such changes. (See *ibid.*) Aware that state legislation unfriendly to national banks had been enacted in the past (see, e.g., Madeleine, Monetary and Banking Theories of Jacksonian Democracy (1943) pp. 21-22; see also *McCulloch v. Maryland, supra,* 17 U.S. (4 Wheat.) at pp. 400-437), Congress was also aware that

such legislation might be proposed in the future (see, e.g., Cong. Globe, 38th Cong., 1st Sess., *supra*, p. 1376). It was evidently to forestall unfriendly state legislation that Senator Sherman urged "most favored lender" status for national banks. (See *id.* at p. 2126; see also fn. 9, *ante.*) Congress must have known that unfriendly state legislation could be predicated on measures other than differential provisions concerning periodic percentage charges payable absolutely by maturity. Without question, it did not purport to limit protection to such charges. A limitation of this sort might not have been inappropriate in an ephemeral measure. But it would have appeared out of place in the National Bank Act. In the words of Representative Hooper, who "reported the bill that was to become the National Bank Act . . . to the House from the Ways and Means Committee" (*Marquette Nat. Bank v. First of Omaha Corp., supra*, 439 U.S. at p. 315, fn. 28), the act was "not for a day" (Cong. Globe, 38th Cong., 1st Sess., *supra*, p. 1377). Quite the contrary. It was to perdure through the system of national banks that it established. Had Congress intended to limit protection, it would doubtless have made itself plain. It did not. Its silence is especially deafening when we consider that the immediate object of the National Bank Act was not the testing of an hypothesis concerning monetary theory, but rather the saving of the Union itself. (See *id.* at pp. 2128-2130.)[10]

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[10] In their separate dissenting opinions, Justice Arabian and Justice George assert – to quote only Justice George – that "[t]here is absolutely nothing in" section 30 of the National Bank Act "that suggests that Congress . . . intended the statutory reference to 'interest' to include" late payment fees. (Dis. opn. of George, J., *post*, at p. ___ [typed dis. opn. of George, J., at p. 4]; accord, dis. opn. of Arabian, J., *post*, at pp. ___-___ [typed dis. opn. of Arabian, J., at pp. 4-6].) Nothing except the word itself, whose broad meaning in American legal usage around the time of the passage of the National Bank Act was a "sum of money paid or allowed by way of compensation for the loan or use of another sum" (2 Burrill, A New Law Dictionary and Glossary, *supra*, p. 629, col. 1) or the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use" (1 Bouvier, A Law Dictionary, *supra*, p. 652, col. 1). Justice Arabian's position is especially curious. He recognizes that the question of the word's meaning is "antiquarian." (Dis. opn. of Arabian, J., *post*, at p. ___ [typed dis. opn. of Arabian, J., at p. 4].) He fails – or refuses – to see that the answer, as revealed in the definitions quoted above, is "antiquarian" as well.

In the years since the enactment of section 30 of the National Bank Act, including its codification in section 85, we have discerned nothing to affect the coverage of the term "interest." Amendments there have been. But none has borne on the point with which we are concerned.

Consequently, we believe that the term "interest" in section 85 should be construed to cover late payment fees, if such fees are allowed by a national bank's home state.[11]

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[11] In his dissenting opinion, Justice George takes the position that the term "interest" in section 85 does not include any contingent charge, including a late payment fee. He founders on *Marquette*. There, the United States Supreme Court treated as "interest" the apparently typical periodic percentage charges on credit card transactions *that are contingent on the borrower's failure to pay his balance in full.* (*Marquette Nat. Bank v. First of Omaha Corp., supra*, 439 U.S. at p. 302.)

Our construction of the term "interest" in section 85 accords with the decisions of practically all other courts. (See, e.g., *Ament v. PNC Nat. Bank, supra,* 849 F.Supp. at pp. 1018-1021; *Tikkanen v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 801 F.Supp. 270, 274-280; *Nelson v. Citibank (South Dakota) N.A., supra,* 794 F.Supp. at pp. 316-320; *Copeland v. MBNA America, N.A.* (Colo. Ct. App. 1994) 883 P.2d 564, 565-566, cert. granted (Colo. 1994) 883 P.2d 564; *Sherman v. Citibank (South Dakota), supra,* 272 N.J.Super. at pp. 440-450; cf. *Greenwood Trust Co. v. Com. of Mass., supra,* 971 F.2d at pp. 829-830 [dealing with section 521 of DIDA: impliedly construing "the term 'interest' [in section 85] to encompass a variety of lender-imposed fees and financial requirements which are independent of a numerical percentage rate," including, evidently, late payment fees on credit card accounts]; but cf. *Copeland v. MBNA America, N.A.* (D.Colo. 1993) 820 F.Supp. 537, 540-541 [criticizing reasoning set out in *Greenwood Trust*].)[12]

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[12] We recognize that, in *Mazaika v. Bank One, Columbus, N.A.* (1994) ___ Pa.Super. ___, ___-___ [653 A.2d 640, 643-647], the Pennsylvania Superior Court, sitting in bank, held that the term "interest" in section 85 must be construed to cover only periodic percentage charges payable absolutely by maturity. In *Gadon v. Chase Manhattan Bank, (USA)* (1995) ___ Pa.Super. ___, ___ [653 A.2d 697, 699], and *In re Citibank* (1995) ___ Pa.Super. ___, ___ [653 A.2d 39, 40], panels of the Pennsylvania Superior Court followed *Mazaika*. We cannot. *Mazaika* – which is essentially unique among reported decisions – is altogether unpersuasive. It asserts, in substance, that in enacting section 30 of the National Bank Act Congress did not "intend[ ] anything other than the ordinary and popular meaning of the word 'interest', which a person of average intelligence and experience would understand," apparently a periodic percentage charge payable absolutely by maturity. (*Mazaika v. Bank One, supra,* ___

Our construction is also in line with interpretations of the Comptroller of the Currency, who "is charged with the enforcement of the [federal] banking laws" (*Investment Co. Institute v. Camp* (1971) 401 U.S. 617, 627; accord, *NationsBank of N.C. v. Variable Annuity Life Ins.* (1995) ___ U.S. ___, ___ [115 S.Ct. 810, 813]). (See, e.g., Office of the Comptroller of the Currency, Notice of Proposed Rulemaking (Mar. 3, 1995) 60 Fed.Reg. 11924, 11940 [proposing to add subsection (a) of section 7.4001 to title 12 of the Code of Federal Regulations, which would provide that "[t]he word 'interest' as used in 12 U.S.C. 85 includes . . . late fees"]; Office of the Comptroller of the Currency, Interpretative Letter by Julie L. Williams, Chief Counsel (Feb. 17, 1995) pp. 9-11; Office of the Comptroller of the Currency, Interpretative Letter by Robert B. Serino, Deputy Chief Counsel (Policy) (Aug. 11, 1988) pp. 5-8; Office of the Comptroller of the Currency, Interpretative Letter by L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) p. 1; cf. Fed. Deposit Insurance Corporation, Advisory Opn. by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47 (July 8, 1992) p. ___ [(1992-1993 Transfer Binder) Fed. Bank. L. Rep. (CCH) ¶ 81,534, p. 55,731] [opining that section 521 of DIDA gives a covered financial institution the "right to charge late fees . . . permitted by [its] home state which are either

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Pa.Super. at p. ___ [653 A.2d at p. 647].) The analysis in the text proves this statement wrong. We note in passing that the Pennsylvania Supreme Court has granted a petition for allowance of appeal in *Mazaika*. (No. 31 E.D. Allocatur Dock., May 25, 1995.) It has done the same in *In re Citibank*. (No. 80 E.D. Allocatur Dock., May 31, 1995.)

a component of interest or material to the determination of the interest rate"].)[13]

Lastly, our construction conforms with views of commentators. (See, e.g., Clark & Clark, The Law of Bank Deposits, Collections and Credit Cards (rev. ed. 1995) ¶ 15.09[2][c], pp. 15-56 – 15-61 & especially pp. 15-59 – 15-60; Rosenblum, *Exporting Annual Fees* (1986) 41 Bus. Law. 1039, 1042-1044.)

Against our conclusion, Smiley argues that the term "interest" in section 85 may not, or at least should not, be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. She asserts that the word should instead be interpreted as such compensation as is *either* "based on the amount of the loan balance" *or* "measured over time" *or* "required up-front as consideration for the loan."

Smiley's argument in favor of her own construction of the term "interest" in section 85 is unpersuasive. On its

[13] We recognize that, in a letter dated June 25, 1964, the then Comptroller of the Currency stated to a correspondent: "[Y]ou inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments . . . are illustrations of charges which are made by some banks which would not properly be characterized as interest." The letter was perfunctory. It did not even mention section 85. We agree with the present Comptroller of the Currency: "It is not clear that the quoted passage was issued in the context of a determination of whether the term 'interest' used in Section 85 includes late charges nor does the context of the letter clearly indicate that it is intended as a ruling of the agency with respect to that question."

very face, her interpretation is peculiar. It is not supported by either reason or authority. Hence, it cannot be accepted. Certainly, it might produce untoward consequences. Specifically, it might effectively limit the variety of credit terms permitted on an interstate loan by a national bank, because any such term beyond its scope would be subject to the varying laws of the several states – a result that might "throw into confusion the complex system of modern interstate banking" (*Marquette Nat. Bank v. First of Omaha Corp., supra,* 439 U.S. at p. 312) and thereby undermine the conditions for uniformity and efficiency that would otherwise obtain. To limit the variety of credit terms would obviously have an adverse effect on the national bank itself, whose freedom to lend on conditions it deems reasonable would be restricted. But it would have a corresponding adverse effect on the national bank's potential customer, whose freedom to *borrow* on conditions *he* deems reasonable would also be restricted. To the extent that Smiley suggests that it is no longer necessary "to protect [national banks] against possible unfriendly State legislation" (*Tiffany v. National Bank of Missouri, supra,* 85 U.S. (18 Wall.) at p. 412), she is wrong. States have continued to enact measures that are unfriendly in effect if not in intent. (See, e.g., *Fisher v. First Nat. Bank of Omaha* (8th Cir. 1977) 548 F.2d 255, 258-261; *Northway Lanes v. Hackley Union Nat. Bank & Trust Co.* (6th Cir. 1972) 464 F.2d 855, 861-864; *United Missouri Bank of Kansas City v. Danforth* (W.D.Mo. 1975) 394 F.Supp. 774, 779-785; *Saul v. Midlantic Nat. Bank/South* (N.J. Super. Ct. App. Div. 1990) 240 N.J.Super. 62, 80-82.)

Smiley's argument against our construction of the term "interest" in section 85 is as unpersuasive as her argument in favor of her own.

In part, Smiley asserts that the term "interest" in section 85 may not be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. To do so, she claims, would compel a conclusion that Congress failed to define the word itself, but rather delegated the task to the several states in violation of section 1 of article I of the United States Constitution, which "vests" in it "[a]ll legislative Powers [t]herein granted." That is simply not the case. Congress has made no such delegation. As shown above, it has itself defined the word, impliedly if not expressly, to cover late payment fees, if such fees are allowed by a national bank's home state. True, it has adopted in this regard, as by a choice-of-law provision, the usury law of the national bank's home state as the rule governing all loans by the bank in question, even interstate loans, notwithstanding the law of any other state. It has thereby entrusted the question of the lawfulness of a national bank's late payment fees to its home state and to its home state alone. But it has not thereby made a delegation. In *United States v. Sharpnack* (1958) 355 U.S. 286, 294, the United States Supreme Court concluded that Congress did not delegate its legislative powers to the several states in the Assimilative Crimes Act of 1948, in which it adopted for each federal enclave the criminal law of the state in which such enclave is situated. Here, we conclude that Congress did not delegate its legislative powers to the several states in section 85, in which it adopted for each national bank the usury law of the state in which such bank is

located. (Accord, *Tikkanen v. Citibank (South Dakota) N.A., supra,* 801 F.Supp. at p. 280; *Sherman v. Citibank (South Dakota), supra,* 272 N.J.Super. at p. 449.)

In other part, Smiley asserts that the term "interest" in section 85 at least should not be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. She says that the word as used in other contexts is of narrower compass. What is dispositive, however, is the word *as used here.*

Some of the non-section 85 authorities on which Smiley relies do not, in fact, show the term "interest" employed in a limited sense. Thus it is with section 521 of DIDA. Its purpose is "to achieve a measure of parity and competitive equity between national banks and" federally-insured state banks and federally-insured branches of foreign banks "by permitting" the latter "to enjoy the same 'most favored lender' status that national banks enjoy." (*Hunter v. Greenwood Trust Co.* (N.J. Super. Ct. App. Div. 1994) 272 N.J.Super. 526, 533, cert. granted (1994) 138 N.J. 270; accord, *VanderWeyst v. First State Bank of Benson* (Minn. 1988) 425 N.W.2d 803, 805-807.) There is no suggestion that "interest" in section 521 of DIDA is more restricted than in section 85. But if there were, it would be based on a fact peculiar to the former, viz., that it was enacted, in part, as a response to a situation that was greatly concerned with "interest" *in the sense of a periodic percentage charge payable absolutely by maturity:* as a matter of national economic necessity, covered financial institutions could not prudently lend money unless they imposed charges that were relatively high (*Greenwood Trust Co. v. Com. of Mass., supra,* 971 F.2d at p. 826); but as a matter of state law, they were required to impose

charges that were relatively low (*ibid.*).[14] It scarcely needs mention that the "legislative history of [section 521 of DIDA], enacted in 1980, does not bear on the legislative history of [section 30 of] the National Bank Act, enacted in 1864." (*Nelson v. Citibank (South Dakota) N.A., supra,* 794 F.Supp. at pp. 319-320.) We surely do not discern in section 521 of DIDA any understanding on the part of Congress that section 85 uses "interest" narrowly. Neither can we detect any intent by that body to implicitly "amend" the latter provision through the former.

By contrast, other of the non-section 85 authorities on which Smiley relies do indeed show the term "interest" employed in a limited sense – but, by definition, not in section 85. Thus, in *U.S. v. Texas* (1993) ___ U.S. ___, ___-___ [113 S.Ct. 1631, 1635-1636] – which does not even allude to section 85 – it is held that federal common law requires a party owing a contractual debt to the United States to pay "prejudgment interest," which evidently

[14] See also Senate Report No. 96-368, 1st Session, page 19 (1979), 1980 United States Code Congressional and Administrative News, at page 255 (dealing with section 501 of DIDA, codified in section 1735f-7a of title 12 of the United States Code, which concerns state law provisions limiting the amount or rate of interest, discount points, or finance or other charges *with respect to mortgage loans:* "In exempting mortgage loans from state usury limitations, the committee [on Banking, Housing, and Urban Affairs] intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers."); accord, subsection (c) of section 590.3 of title 12 of the Code of Federal Regulations (1995) (administratively implementing section 501 of DIDA by regulation).

does not include "processing fees" or "penalty charges." But "prejudgment interest" under this rule has nothing to do with "interest" in section 85. Similarly, in section 102 et seq. of the Truth in Lending Act (hereafter TILA), which has been codified in section 1601 et seq. of title 15 of the United States Code, and its implementing administrative regulation, Regulation Z, which has been codified in part 226 of title 12 of the Code of Federal Regulations (1995) – neither of which even cites section 85 – "finance charge" is defined to include "interest" (15 U.S.C. § 1605(a)(1); 12 C.F.R. § 226.4(b)(1) (1995)) but to exclude, for example, late payment fees (12 C.F.R. § 226.4(c)(2) (1995)). But "finance charge" under this provision and regulation has nothing to do with "interest" in section 85. Moreover, the purpose of TILA is substantially different from that of section 85, inasmuch as the former "provides for full disclosure of credit terms rather than regulation of the terms or conditions under which credit may be extended" (*Johnson v. McCrackin-Sturman Ford, Inc.* (3d Cir. 1975) 527 F.2d 257, 262), whereas the latter is concerned with the regulation of such terms and conditions insofar as they may be established by national banks.[15]

[15] Other of the non-section 85 authorities on which Smiley relies are no more helpful to her cause. See, e.g., *Lloyd v. Scott, supra,* 29 U.S. (4 Pet.) at page 226 (pre-National Bank Act decision: not defining "interest"; stating that "a specific sum, exceeding the lawful interest," in case of late payment is not usury but a permissible penalty if avoidable by timely payment); *Spain v. Hamilton's Administrator, supra,* 68 U.S. (1 Wall.) at pages 625-626 (pre-National Bank Act decision: to similar effect); *Insurance Company v. Piaggio* (1872) 83 U.S. (16 Wall.) 378, 386 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; stating that a party

In addition, Smiley specifically asserts that the term "interest" in section 85 necessarily excludes late payment fees (at least such as are calculated as flat fees) because they are "penalties." That is simply not the case. (See *Sherman v. Citibank (South Dakota), supra,* 272 N.J.Super. at p. 447 [stating that "there is nothing in the dictionary definition of interest which necessarily excludes late fees from the scope of that term"]; cf. *Citizens; National Bank v. Donnell* (1904) 195 U.S. 369, 373-374 (per Holmes, J.) [implying that "interest" under section 30 of the National Bank Act may include overdraft charges].)

"cannot recover special damages for the detention of money due to him beyond what the law allows as interest"); *United States v. Childs* (1924) 266 U.S. 304, 307 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; stating that a "penalty is a means of punishment; interest a means of compensation"); *Kothe v. R.C. Taylor Trust* (1930) 280 U.S. 224, 226 (not defining "interest," either generally or under section 85 specifically; distinguishing liquidated damages and penalties); *Merchants' Nat. Bank v. Sevier* (C.C.E.D.Ark. 1882) 14 F. 662, 665 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; implying that parties may not "lawfully stipulate for the payment of an attorney's fee, *in addition to* the principle [*sic*] and interest of the debt, and the costs and fees allowed by law" (italics added)); *In re Tastyeast, Inc.* (3d Cir. 1942) 126 F.2d 879, 882 (not defining "interest," either generally or under section 85 specifically: similar to *Kothe*); *Smith Mach. Co., Inc. v. Jenkins* (10th Cir. 1981) 654 F.2d 693, 696 (not defining "interest," either generally or under section 85 specifically: similar to *Lloyd* and *Spain*).

In his dissenting opinion, Justice George relies on a number of the non-section 85 authorities that we have considered. (See dis. opn. of George, J., *post*, at pp. ___-___, fn. 1 [typed dis. opn. of George, J., at pp. 5-6, fn. 1].) To no avail. (See p. ___, fn. 14, & pp. ___-___, *ante* [typed opn. at p. 29, fn. 14, & pp. 30-20].)

To the extent that Smiley maintains that late payments fees are, or at least were, unlawful per se under the common law, she is wrong. (See Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. at pp. 1214-1223; Annot, Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious or Otherwise Illegal (1969) 28 A.L.R.3d 449, 454-465.)

To the extent that Smiley maintains that late payments fees are unjustifiable as a matter of policy, she is also wrong. As a general matter at least, late payment has no social utility. Indeed, it causes various costs relating to default, including collection – costs that may be especially high when, as is typically the case in credit card transactions, the underlying loan is unsecured. Late payment fees may be employed to impose default costs on late payers, who are responsible for them, and to avoid shifting them to timely payers, who are not. Fairness is served thereby: late payment fees make late payers shoulder the burden they themselves have created. In addition, the efficient use of limited resources is furthered: late payment fees deter late payers from creating the burden in the first place. Without question as to their legitimacy, differential periodic percentage charges payable absolutely by maturity are used to impose default costs, albeit *prospectively* on *projected* late payers, with higher or lower charges depending on the borrower's creditworthiness. It can be argued that late payment fees may properly be used to achieve the same end *retrospectively* on *actual* late payers: it may be said to be more equitable to require a given sum in late payment fees after the term of the loan from a borrower who turns out to be late than to extract

the same – or perhaps a greater – sum through a higher periodic percentage charge payable absolutely by maturity throughout the loan's term from a borrower who proves himself to be timely.

Smiley may then be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive – or, in *Marquette's* word, "exportable" – against a sister state's law involving its " 'historic police powers' " in consumer protection and banking, " 'unless that [is] the clear and manifest purpose of Congress.' " (*Cipollone v. Liggett Group, Inc., supra,* ___ U.S. at p. ___ [112 S.Ct. at p. 2617].) As *Marquette* effectively holds, such a purpose may indeed be discerned in section 85. To the extent that she asserts that federal law may not preempt state law of this sort other than expressly, she finds no support in reason or authority.

Smiley may next be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive against a sister state's law beyond periodic percentage charges payable absolutely by maturity, or, perhaps more broadly, beyond such charges as are *either* "based on the amount of the loan balance" *or* "measured over time" *or* "required up-front as consideration for the loan." We do not see any logical basis for such a limitation. (See *Tikkanen v. Citibank (South Dakota) N.A., supra,* 801 F.Supp. at p. 277 [stating that "nothing in the language of section 85 supports a definition of interest that fluctuates according to whether the national bank seeks to apply the interest

to interstate or intrastate transactions"]; *Nelson v. Citibank (South Dakota) N.A., supra,* 794 F.Supp. at p. 320 [stating that such a definition "is without statutory support" and is in fact "untenable"].) Neither do we see any practical ground therefor. Substance must prevail over form. Simply put, a borrower is equally affected by paying $15 in periodic percentage charges payable absolutely by maturity or $15 in late payment fees. (See *First National Bank in Mena v. Nowlin* (8th Cir. 1975) 509 F.2d 872, 878.)

Smiley may lastly be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive against a sister state's *common law.* She is unpersuasive. Her sole basis is section 521 of DIDA, which is inapplicable, or more accurately her peculiar interpretation of that provision, which is over-narrow (see *Hunter v. Greenwood Trust Co., supra,* 272 N.J.Super. at pp. 537-540). Contrary to her underlying assertion as to the latter provision, *Cipollone v. Liggett Group, Inc., supra,* ___ U.S. ___ [112 S.Ct. 2608], did *not* hold that "implied pre-emption cannot exist when Congress has chosen to include an express pre-emption clause in a statute." (*Freightliner Corp. v. Myrick* (1995) ___ U.S. ___, ___ [115 S.Ct. 1483, 1487].)

In making her various arguments, Smiley criticizes the reasoning of the *Greenwood Trust* court and the views of the Comptroller of the Currency. Since we have not relied on either except to show that the conclusions that

we ourselves have arrived at are not novel, we need not respond to her complaints.[16]

We acknowledge that, to construe the term "interest" in section 85 to cover late payment fees, if such fees are allowed by a national bank's home state, would empower a national bank to "export" its home state's law of usury in that regard. We also acknowledge that such "exportation" of the usury law of a national bank's home state would prevent sister states from enforcing their own usury laws to that extent against the national bank in question by entrusting the question of the lawfulness of the national bank's late payment fees to its home state and to its home state alone. We cannot, and do not, ignore the immanent [sic] threat to efforts by sister states to provide such protection as they deem fit to consumers who reside therein. But – to follow *Marquette* – this displacement of the usury laws of sister states has always been implicit in the structure of the National Bank Act, since residents of one state have ever been free to visit another to receive credit subject to the latter's usury law, even when that law permits unlimited interest. This displacement may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards. The protection of the usury laws of sister states, however, is an issue of policy committed to Congress. Any plea to amend section 85 to

[16] *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, and *Beasley v. Wells Fargo Bank* (1991) 235 Cal.App.3d 1383, on which Smiley relies, are each inapposite. None even mentions section 85.

further that end must be addressed to that body and not to this.

C

Applying the law as set out above, we must reject Smiley's contention that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings.

Confining ourselves to Smiley's complaint and accepting as true all material facts alleged therein, we believe that the pleading does not state facts sufficient to constitute a cause of action against Citibank.

Smiley's complaint is based on California law bearing on the amount of late payment fees. It is, however, without support because that law is preempted as to Citibank through section 85. Citibank is a national bank. Its home state is South Dakota. Because the term "interest" in section 85 covers late payment fees, if such fees are allowed by a national bank's home state, it embraces Citibank's late payment fees, which are permitted by South Dakota pursuant to section 54-3-1 of the South Dakota Codified Laws. Whether California law would prohibit such fees, at least under certain circumstances, is of no consequence. That law is displaced.[17]

[17] We note in passing that Citibank's late payment fees appear roughly comparable with those authorized by the subsequently added section 4001 of the Financial Code, which deals with late payment fees. (See fn. 2, *ante*.)

Against our conclusion, Smiley argues to the following effect: her complaint "alleges" as a "material fact" that Citibank's late payment fees for its credit card accounts are not late payment fees *within the meaning of South Dakota law,* but rather "penalties"; if this "material fact" is accepted as true, California law bearing on the amount of late payment fees is not preempted as to Citibank through section 85; and if California law is not preempted in this regard, the superior court's order granting Citibank's motion was erroneous and the Court of Appeal's conclusion upholding that order was erroneous as well.

We are not persuaded. Smiley's complaint simply does not "allege" as a "material fact" that Citibank's late payment fees for its credit card accounts are not late payment fees within the meaning of South Dakota law, but rather "penalties." Indeed, the pleading does not even allude to South Dakota law at all. With the premise of her argument gone, the conclusion falls of its own weight. In any event, we ourselves have considered the question independently, and conclude that the late payment fees in question are indeed late payment fees

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We also note in passing that Smiley's construction of the term "interest" in section 85 as such compensation for use of money under loan as is *either* "based on the amount of the loan balance" *or* "measured over time" *or* "required up-front as consideration for the loan" seems broad enough to embrace Citibank's late payment fees for its "Preferred" credit card accounts, at least in part, because those fees – as shown by matters of which we have taken judicial notice (see fn.2, *ante*) – appear, at least in part, to be set with regard to the account balance *and* to be determined over monthly periods.

within the meaning of South Dakota law, and not "penalties."[18]

III

For the reasons stated above, we conclude that the judgment of the Court of Appeal must be affirmed.

It is so ordered.

MOSK, ACTING C.J.

WE CONCUR:
KENNARD, J.
BAXTER, J.
WERDEGAR, J.
ARDAIZ, J.*

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[18] Smiley may be understood to contend that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings *insofar as that order failed to grant her leave to amend her complaint.* The claim fails. True, leave to amend a complaint – like the present – that does not state facts sufficient to constitute a cause of action should generally be granted if there is a reasonable possibility that the defect can be cured. (See, e.g., *Carney v. Simmonds* (1957) 49 Cal.2d 84, 97.) No possibility of this sort appears here. Certainly, the defect cannot be cured by "alleging" as a "material fact" that Citibank's late payment fees are not late payment fees within the meaning of South Dakota law.

* Hon. James A. Ardaiz, Presiding Justice, Court of Appeal, Fifth District, assigned by the Acting Chairperson of the Judicial Council.

DISSENTING OPINION BY ARABIAN, J.

I dissent. The majority offers up a thoroughgoing revision of the history of American banking to justify a result that could not conceivably have been in the minds of the members of the Civil War Congress. It is, moreover, one that ignores not only an unambiguous statutory text and a consistent legislative history but what is perhaps the most prominent feature of American banking since the National Bank Act was passed in 1864 – the "dual banking system," under which Congress has historically deferred to the interests of the states in the regulation of national banks as to all matters except those essential to their role as instrumentalities of the federal government.

The setting of *non*-interest-rate credit card terms – like the late payment penalties charged California credit card users by out-of-state national banks at issue in this case – is a matter appropriate for regulation by the California Legislature. It is not one to be determined by the legislatures of a handful of small or sparsely populated states that have deregulated consumer credit in an attempt to attract the interstate credit card operations of large national banks.[1]

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[1] Examining the shifting terrain of modern American banking in 1981, Judge Douglas Ginsburg wrote that "We have already seen Citicorp relocating some of its retail operations in South Dakota, and the Chase Manhattan and Morgan banks undertaking similar moves to Delaware. . . . In return for jobs and taxes, these jurisdictions have traded local entry rights and powers, but in each case their real purpose is to serve as a base state for national retail banking: the national charter enables the banks to extend credit to residents of other states at their new 'home' state interest rate, and newly provided state laws make

It may be that a nationwide banking system, especially in the consumer financial services marketplace, is the inexorable future of American banking. We have not as a nation reached that point, however, and the decision to do so and the means by which a truly interstate system of banking is to be effected are matters for Congress to decide, not a few large national banks aided by the compliant legislatures of South Dakota and Delaware.[2]

I

The majority begins with the proposition that the purpose of the National Bank Act of 1864 (12 U.S.C.) was to grant to the newly established national banks "most favored lender status" by permitting them to charge the

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these interest rates unlimited." (Ginsburg, *Interstate Banking* (1981) 9 Hofstra L. Rev. 1133, 1370, fns. omitted.)

[2] It is worth noting that the power of the South Dakota legislature to affect the interests of California credit card holders endorsed by the majority is not limited to the setting (or the removal) of ceilings on late payment penalties; it encompass [sic] as well the manipulation of the following credit card charges: annual fees, grace periods, conditions of default, changes in terms provisions, bad check charges, and restrictions on the imposition of attorneys' fees and collection costs. (See Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions* (1987) 42 Bus. Law. 929, 930.) As the majority point out, the Legislature enacted a measure effective January 1, 1995, adding division 1.1 to the Financial Code, dealing with the setting of fees in consumer credit transactions. (See maj. opn., *ante*, at p. ___, fn. 2 [typed maj. opn. at p. 6, fn. 2].) Notwithstanding this recent change, the federalist question remains not how the Legislature has decided to regulate consumer financial services, but the extent of its power to act as it sees fit.

highest *rate of interest* allowed to lenders (including non-bank lenders) by the state in which the national bank is located. That, I agree, is the holding of the high court in *Tiffany v. National Bank of Missouri* (1873) 85 U.S. (18 Wall.) 409 (*Tiffany*). From the platform of this almost common-place perception, rooted in the language of the *Tiffany* opinion itself, the majority then vaults to tne far more disputable conclusion that Congress must have had in mind, not only "interest" in its "popular sense" – a sum charged for the lending of money, calculated at a periodic percentage over time, that is, *rates* of interest – but non-interest-rate credit terms such as, in this case, "late payment fees, if such fees are allowed by a national bank's home state." (Maj. opn., *ante*, at p. ___ [typed maj. opn. at p. 19].)

This expansive definition of interest is required, according to the majority, not because of any evidence that Congress *actually* had such an idea in mind when it enacted the National Bank Act; in fact, there is not a particle of textual or legislative evidence to support such a view. Instead, the majority reasons that Congress must have intended to give "interest" such a broadened definition because limiting the word's meaning to the one that is obvious on the face of the statute would have allowed unfriendly state legislatures to "frustrate" the rise of the national banks by passing discriminatory measures imposing low *non-interest* terms (such as late fee penalties) on such banks while increasing the ceilings on such charges that state banks could impose. Such a course would have led to the destruction of the national banks, the majority reasons, an outcome Congress could not

have desired. To avoid such a result, the majority concludes, "the term 'interest' in section 30 of the National Bank Act should be construed to cover late payment fees. . . . " (Maj. opn., *ante*, at p. ___ [typed maj. opn. at p. 19].)

Like the proverbial red thread, a misconception not only of the high court's opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, but of the economic conditions prompting the enactment of the National Bank Act on which the *Tiffany* opinion rests, runs through the logic of the majority's view. A sharp pull on this skein of error – by demonstrating the misreading of *Tiffany* and of the larger historical context of American banking in the immediate aftermath of the Civil War – and the fabric of the opinion unravels.

A

We begin with the text of the statute itself. In enacting what was originally section 30 of the National Bank Act in 1864, Congress used the word "interest" a total of four times. It used the word "rate," however, a total of *nine* times, more than twice as often as it used the word "interest." Indeed, "interest" *does not appear in a single sentence of section 30 unaccompanied by the word "rate"*; the statute commonly links directly the two ideas, referring to "rates of interest" or "interest at a rate of," although sometimes it refers to "rates" *without* referring to "interest" in the same sentence. Whatever broader currency the word "interest" may have had in American society at large in the mid-19th century, uncoupled from the notion of rates, it is highly likely that in enacting section 30,

Congress actually had in its collective mind a much narrower and more precise understanding, the one the majority calls the "popular sense" of the word: a sum linked to the lending of money calculated at a *rate* or a percentage of the loan over time.

Such a self-evident and unambiguous use of the term should mark the end of the inquiry, the question before this court being, after all, the antiquarian one of the content Congress probably ascribed to a word inserted in a statute in 1864. The answer, it is evident to me, is furnished by the text of the statute itself. Another court, examining the identical question, and rejecting the very construction placed on the text by the majority, has written that "a proposition that is not obvious from the plain meaning of a statute's language, nor from its legislative history, simply cannot be regarded as a clear manifestation of congressional intent." (*Copeland v. MBNA America, N.A.* (D.Colo. 1993) 820 F.Supp. 537, 541; see also *Mazaika v. Bank One, Columbus, N.A.* (Pa. Super. Ct. 1994) 653 A.2d 640, 647 (in bank) [" . . . we are simply unable to find that Congress, when it used the phrase 'interest at the rate' in enacting Section [30] . . . intended anything other than the ordinary and popular meaning of the word 'interest', which a person of average intelligence and experience would understand. (Fn. omitted.)"].)

During the Senate debate on the bill that became the National Bank Act, moreover, the talk was of interest "rates," not of abstract notions of interest encompassing the expansive formulation of the majority. Thus, in the midst of the debate over the bill's terms on May 5, 1864, the senators discussed the controversial proposal whether to enact into law a national interest rate ceiling of 7

percent. Senator Grimes of Iowa sought to have the ceiling reduced to 6 percent, the figure prevailing in his state. "This bill purports to be a bill to provide a national currency, and its friends claim that it is to have a uniform operation all through the country. Let me tell the Senate how it will operate in [Iowa]. In the State of Iowa the legal *rate of interest* is six per cent., but where special contracts are entered into the parties can receive ten *per cent.* Under this bill as it stands each of these national banks can receive ten *per cent.* on all its discounts and all its monetary transactions, while in the adjacent States the rate will be only six *per cent.*" (Cong. Globe, 38th Cong., 1st Sess. 2123 (1864).)

After further criticizing the measure, the senator concluded, "This is no time to be increasing the *rate of interest.*" Senator Pomeroy of Kansas disagreed: "I only desire to say that I think a uniform *rate of interest* is desirable and should be fixed in this bill, if it is to be a bill to establish a national currency. . . . " Senator Trumbull disagreed with both of his colleagues. "Money is worth more in some portions of the country than others. Money commands a higher *rate of interest* in new sections of the country than it does in the old. . . . This provision . . . allows the same *rate of interest* in a State which is allowed by the laws of the State." (Cong. Globe, 38th Cong., 1st Sess. 2123-2124 (1864), italics added throughout.)

Examples could be multiplied, but there would be little point. The fact is that there is literally nothing in the reported debates on the bill that became the National Bank Act of 1864 to suggest that the drafters of the measure had anything in mind beyond the common

sense, conventional notion of "rates of interest." The record of the congressional debates on the meaning of "interest" as Congress used it in the National Bank Act is thus further evidence – in addition to the unambiguous text of the statute itself – that Congress had in mind a notion of interest that was linked ineluctably to rates. (See Cong. Globe, 38th Cong., 1st Sess. 2123-2125, *supra.*)

B

Indeed, the repeated and uniform linkage of "interest" with "rates of interest" in both statutory text and Senate debate is so clear and unwavering that even the majority quickly abandons any pretense of adhering to the plain meaning of the statute. Instead, it falls back on a kind of argument from necessity which it then projects onto an undisclosed consciousness of the Civil War Congress. The source of this line of argument is the high court's opinion in *Tiffany, supra,* 85 U.S. (18 Wall.) 409, mobilized by the majority as the pivot for an expansive reading of the word "interest" as it appears in section 30 of the National Bank Act.

Here is the argument deployed by the majority to support its central conclusion: "Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks,* but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks,* at a level high enough that *they* could lend at a profit. Such a result would be untenable." (Maj. opn., *ante,* at p. ___ [typed maj. opn. at pp. 19-20], italics in original.)

A fair reading of the opinion in *Tiffany, supra,* 85 U.S. (18 Wall.) 409, however demonstrates that the high court, writing a mere nine years after the passage of the National Bank Act, alluded not to Congress's fear of the specter of discriminatory rate setting against *national* banks by the states, but to its concern that state legislatures might abolish *all banks,* state *and* federal. Such an anxiety over the fate of the entire business of banking lends no support to the majority's claim that Congress must have been motivated to provide against the contingency of discriminatory rate setting by incorporating (with conspicuous silence) an understanding of "interest" that includes charges unrelated to what is the obvious subject of section 30 – that is, "rates of interest."

Here is the critical text of Justice Strong's opinion in *Tiffany, supra,* 85 U.S. (18 Wall.) 409, upon which the majority relies for its central tenet that Congress must have had in mind a notion of interest broad enough to encompass not just rates of interest, but non-interest-rate credit card terms including, in this case, late payment penalties, in order to avoid state discrimination against national banks: "It was expected that [national banks] would come into competition with State banks, and it was intended to give them at least equal advantages in such competition. In order to accomplish this they were empowered to reserve interest at the same rates . . . which were allowed to similar State institutions. This was considered indispensable to protect them against possible unfriendly State legislation. Obviously, if State statutes should allow [state] banks . . . a rate of interest greater than the ordinary rate allowed to natural persons, National [banks] could not compete with them, unless allowed the same. On the other hand, if such [national

banks] were restricted to the rates allowed . . . to [state] banks . . . , unfriendly legislation might make their existence in the state impossible. A rate of interest might be prescribed so low that *banking could not be carried on*, except at a certain loss." (85 U.S. (18 Wall.) at pp. 412-413, italics added.)

I suppose it is possible to construe this text as referring to the threat of state discrimination against national banks by the setting of interest rate differentials that favored state banks. In point of historical fact, however, the greater likelihood is that Justice Strong had in mind what the words of his opinion literally convey: that the states might enact legislation that, far from favoring state banks over national banks, would sweep away *all banks*, leaving the business of lending (and the circulation of bank notes) to *non-bank* lenders. In other words, just as Justice Story wrote in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, 413, that "*banking* [not merely *national* banking] could not be carried on" in the face of across-the-board interest rate ceilings that would have made the business of banking itself a losing proposition. The radical policy of prohibiting banks had in fact been adopted in some of the states – Texas (1845), and Iowa and Arkansas (both in 1846), among them – in the not too distant past. (See Hackley, *Our Baffling Banking System* (1966) 52 Va. L. Rev. 565, 570 and fn. 20 (hereafter Hackley); Hammond, Banks and Politics in America (1957) p. 614.)

At this historical distance, it is easy to lose sight of the fact that in 1864 the history of American banking had been one of decades of financial turmoil, cyclical bank "panics," the sudden appearance and disappearance of "wildcat" banks, the absence of a national currency (and

of national banks), and volatile, often worthless notes issued by private state-chartered banks. The country's first "central bank," the Bank of the United States, had been destroyed in its second incarnation by President Jackson's veto of its charter renewal in 1832. The following period, roughly from 1836 to 1863, often referred to as the era of "free banking," was one of the most chaotic in American financial history, an era in which all banking was carried on by state chartered banks that issued their own currencies and in which the very idea of banks and bankers came to be distrusted by many Americans.[3] (Hackley, *supra*, 52 Va. L. Rev. at p. 570; Hammond, Banks and Politics in America, *supra*, at pp. 605-622, 725-26; Million, *The Debate on the National Bank Act of 1863, supra*, 2 J. of Political Economy 251, 261-266.)

The debased currencies of the state banks, together with the federal government's complete withdrawal from the field of financial regulation during the Jackson administration, contributed in the minds of many to the rebellion of the slave-holding states. With enormous

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[3] A vivid sense of what must have seemed the financial chaos surrounding the most everyday affairs of the average citizen can be gained from the observations of a writer in the January 1863 issue of Merchants' Magazine describing the currency of the West as including "the 'shinplasters' of Michigan, the 'wild-cats' of Georgia . . . the 'red-dogs' of Indiana and Nebraska, the miserably engraved 'rags' of North Carolina and Kentucky . . . and the not-soon-to-be-forgotten 'stumptail' of Illinois and Wisconsin. . . . " (Quoted in Million, *The Debate on the National Bank Act of 1863* (1894) 2 J. of Political Economy 251, 264, fn. 2.) In an era of ubiquitous Federal Reserve notes, it requires an act of imagination to realize that these characterizations were applied to what at the time passed for money.

sums suddenly and urgently required by the national government to pay its troops and finance the widening war, it is little wonder that Salmon Chase, Lincoln's Treasury Secretary, should call on Congress to enact legislation establishing a uniform national currency to be issued by federally chartered banks. Thus the immediate impetus for the National Bank Act.[4]

Against this backdrop, what Congress likely feared was not that the states would favor their local banks over those holding newly issued federal charters by setting discriminatory interest rates, but that the institution of private commercial banking itself would be abandoned in favor of other forms of lending in a country that, though still in its financial youth, had had much bitter experience

[4] To Secretary Chase and others, one of the central objectives of the National Bank Act and allied legislation was the destruction of the state banking system and the assumption of federal control of the nation's banking, a condition that almost came to pass after Congress levied a 10 percent tax on state bank notes in 1865, prompting most of the state banks to convert to federal charters and marking the end of the era of state bank notes. Between 1864 and 1869, the number of state banks fell from a high of 1,089 to a low of 259, while national banks increased from 467 to 1,617. (See Anderson, Federal and State Control of Banking (1934) pp. 72-74; Redford, *Dual Banking: A Case Study in Federalism* (1966) 31 Law & Contemp. Prob. 749, 755.) State banks launched a come-back of sorts over the following decades, primarily because of the increasing importance of banks drafts in lieu of money, eventually achieving a rough equilibrium with their national competitors. It is this historically inadvertent coexistence of state and federally chartered banks in the aftermath of the National Bank Act that has come to be referred to as the "dual" banking system. (See, e.g., Hackley, *supra*, 52 Va. L. Rev. 565, 572.)

with a system that relied on largely unregulated state-chartered banks for its medium of exchange. It was thus to induce state banks to convert their charters and to protect the future of *banking* itself, that Congress tied national bank interest rate ceilings to those set by local legislatures for lenders *other than* state banks.[5]

That linkage, however, gives no support to the majority's argument that Congress must have intended to invest the term "interest" with a meaning that is broader than the text of the statute and legislative materials will support. Because Congress's aim in allowing national banks to adopt the highest rate of interest charged by non-bank lenders was not to head off local efforts to destroy national banks by setting discriminatory fees favoring state banks, there is no historical or legal basis for the conclusion that the term " 'interest' in section 30 . . . should be construed to cover late payment fees. . . . " (Maj. opn., *ante*, at p. ___ [typed maj. opn. at p. 19].)

C

There is another thread prominent in the intellectual fabric of the immediate post-Civil War era that reinforces

[5] As one comment has observed, at the time the *Tiffany* opinion was written, national banks outnumbered state banks by a ratio of seven to one, the latter being in a general state of collapse in the aftermath of the federal impost on their circulating notes. Faced with the impending "nationalization" of banking, "it is not inconceivable that states would enact retaliatory usury laws so that profitable loans could be made only by nonbank lenders." (Comment: *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View* (1982) Vill. L. Rev. 1077, 1085, fn. omitted.)

the view that in its opinion in *Tiffany, supra,* 85 U.S. (18 Wall.) 409, the high court had in mind, not discriminatory fee differentials directed at national banks, but the legislative abolition of banks themselves. That is the already well-rooted constitutional doctrine, perhaps then even more vivid in the minds of lawyers and judges than it is today, of federal instrumentalities and their correlative immunity from impairment by state laws. It was, after all, two cases involving the Bank of the United States that Chief Justice Marshall had chosen as the vehicles to establish the proposition that "the bank is an instrument which is 'necessary and proper for carrying into effect the powers vested in the government of the United States' " and was thus immune from state taxation. (*Osborn v. Bank of the United States* (1824) 22 U.S. (9 Wheat.) 738, 860; see also *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316, 436-437 [" . . . this is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."].)

It was only two years after *Tiffany, supra,* 85 U.S. (18 Wall.) 409, was decided that the court decided the *Dearing* case (*Farmers' and Mechanics' National Bank v. Dearing* (1875) 91 U.S. 29), reaffirming the view that the privately owned national banks were "instruments designed to be used to aid the government in the administration of an important branch of the public service." (*Id.* at p. 33.) There is thus no doubt whatever that not only Justice Strong and the high court of 1873, but the Congress of 1864, well knew that no state constitutionally could enact

measures, like differential rate ceilings, which discriminated against the national banks as fiscal instrumentalities of the national government. Given that widespread recognition in legislative and legal circles, there is simply no warrant for the inference by the majority that Congress must have used the word "interest" in a sense broader than the text will support in order to neutralize state efforts to favor state over federally chartered banks.

II

The second line of argument anchoring the majority's broadened reading of the word "interest" in section 30 is derived from the comparatively recent decision in *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299 (*Marquette*) – the only high court opinion that speaks to the doctrine of "exportation" as a species of federal preemption. (See maj. opn., *ante,* at pp. ___-___ [typed maj. opn. at pp. 11-12].) Although the majority avoids any express reference to the context in which the case before us arises and to the forces that drive both it and companion litigation across the nation – the recent emergence of truly "interstate" or nationwide banking in the area of consumer financial services – they rely heavily on the high court's reasoning in *Marquette* to support the conclusion that inequalities between late charge ceilings set by California and those allowed Citibank by the South Dakota legislature have "always been implicit in the structure of the National Bank Act." (Maj. opn., *ante,* at p. ___ [typed maj. opn. at p. 34].) They are "implicit," of course, only if one accepts the flawed reasoning of the majority that when Congress spoke of "interest rates" it

really meant something more than that, namely, *non-interest-rate* charges, including late payment penalties.

The vice of this reasoning is that neither the high court in *Marquette, supra,* 439 U.S. 299, nor the Congress of 1864 wrote or legislated against a backdrop of interstate banking, an arrangement that did not exist even in 1978 and was inconceivable in 1864. Instead, both the *Marquette* court and the Congress that debated and passed the National Bank Act acted against the backdrop of a geographically confined, *intrastate* system that has characterized American banking since the founding of the nation and only now appears to be in a state of rapid disintegration. (See, e.g., Miller, *Interstate Banking in the Court* (1985) Sup. C. Rev. 179; Huertas (1983 Benston edit.) The Regulation of Financial Institutions: A Historical Perspective on Current Issues – The Changing Institutions and Government Policy (1983) 1, 26-27; Ginsburg, *Interstate Banking, supra,* 9 Hofstra L. Rev. 1133; see also *Bank Regulators Set Interstate Guidelines,* N.Y. Times, May 9, 1995 (at p. C1, col 6) [state bank regulators disclose new guidelines putting into effect laws allowing interstate banking].)

The opinion in *Marquette, supra,* 439 U.S. 299, of course, addressed only the question of interest *rates;* it does not hint at, much less embrace, the Pickwickian notion of "interest" embraced by the majority. Moreover, the high court's statement in *Marquette* that in enacting the National Bank Act, Congress debated the measure "in the context of a developed interstate loan market" (*id.,* at p. 317), is of little value to the majority's reasoning. It simply does not follow from the premise of *Marquette* – that because the Congress of 1864 was aware of the

regional nature of the American economy, inequalities in interstate interest rates were implicit in section 30 – that Congress must have used the term "interest" in section 30 to include *non-interest-rate* credit terms such as late payment penalties.

Given the system of regional banking that even today continues to be the prevailing pattern, it is evident that in 1864 American banks did not "export" rates across state lines or that they even conceived of doing so. Congress thus could not have legislated with an awareness, however unarticulated, of "true" interstate banking as we are only coming to perceive it, however dimly, today. The pressures that drive the economic behavior of Citibank and like banks (and that lead to class actions such as this one) were unknown to the world of American banking until around 20 years ago. Because the Congress of the Civil War era could not have foreseen such developments, it could not have enacted section 30 of the National Bank Act with the idea of "interest" in mind that the majority attributes to it, that is, one that permits the exportation of credit terms – including late payment penalties – unrelated to interest rates allowed by the exporting bank's home state.

In short, the "exportation" of interest rates is a phenomenon associated with the contemporaneous rise of true interstate banking. There is certainly no hint of it in the *Tiffany* opinion, which deals solely with interest rates in the intrastate context. The word itself, in the context of banking, does not appear in the case law until around the time of the high court's opinion in *Marquette, supra,* 439 U.S. 299, in 1978. (See generally, Clark, The Law of Bank Deposits (3d ed. 1990) § 11.09[2], pp. 1145-1148.) The

result in *Marquette*, although based in part on the conclusion that the Civil War Congress was sensitive to the development of a system of regional banking (439 U.S. at p. 317), does not depend on the entirely retrospective idea that the Congress that enacted section 30 was in any sense aware of the future exfoliation of interstate banking a century and a quarter later, with its manifold pressures to nationalize credit card interest rates and consumer credit terms generally. (See generally, Ginsburg, *Interstate Banking, supra*, 9 Hofstra L. Rev. at p. 1135.)

It is clear, in short, that the majority reads back into the intent of the Civil War Congress an anachronistic awareness of the imperatives of modern interstate banking, an awareness that, because it did not exist at the time, could not have weighed on Congress's collective consciousness. It is equally clear from the historical materials that Congress was concerned with ensuring the survival of the newly established national banks in the context of a banking industry geographically confined within a single state and operating through single outlets. To thus suggest, as the majority does, that the power of South Dakota to dictate *non*-interest-rate terms to California credit card holders in violation of California law is "implicit" in the word "interest" as it was meant by the framers of the National Bank Act represents an account of the history of American banking that cannot be squared with the reality.

III

Having relied on the foregoing materials and arguments – the clear and unambiguous text of the statute

itself, the tenor of the debate in the Senate, the high court's opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, the bitter national experience against which these events took place, and modern patterns in the nation's banking marketplace – it must be said that, in the end, the truth of none of these matters need be established in order to undermine the majority's conclusion. Because the principle of exportation is a branch of the doctrine of federal preemption, the governing test requires only a showing that the purpose ascribed to Congress by the majority is *less than* "clear and manifest." (*Cipollone v. Liggett Group, Inc.* (1992) 505 U.S. ___ [112 S.Ct. 2608, 2617]; *Mangini v. R.J. Reynolds Tobacco Co.* (1994) 7 Cal.4th 1057, 1066.)

So solicitous has Congress historically been of the interests of the states in the regulation of banking, both state and federally chartered, that the high court has adopted an especially restrictive standard of preemption by which to judge federal laws that impact state regulation of federal banks. That test, announced by the high court at least a century ago in such cases as *McClellan v. Chipman* (1896) 164 U.S. 347, requires the invalidation of a state law *only* where it " 'incapacitates the [national] banks from discharging their duties to the government. . . . ' " (*Id.* at p. 357; see also *Anderson National Bank v. Luckett* (1944) 321 U.S. 233, 248 [invalidation only where state laws "infringe the national banking laws or impose an undue burden on the performance of the banks' functions"]; *Lewis v. Fidelity Co.* (1934) 292 U.S. 559, 566 [subject to state law unless it "interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with a paramount federal law"]; *First National Bank v. Kentucky* (1869) 76 U.S (9 Wall.) 353, 362; *Davis v.*

Elmira Sav. Bank (1896) 161 U.S. 275, 283; see also Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation* (1979) 32 Stan. L. Rev. 687, 690-695.)

The preemption test specially applicable to state banking laws as they affect national banks, reflecting as it does a generous deference to state banking laws in the regulation of federally chartered banks, is consistent with the long history of the dual banking system, one feature of which is that "[n]ational banks 'are subject to the laws of the State and are governed in their daily course of business far more by the laws of the State than of the nation.' " (*McClellan v. Chipman, supra,* 164 U.S. at pp. 356-357, quoting *National Bank v. Commonwealth* (1869) 76 U.S. (9 Wall.) 353, 362.) As we said of the dual system in *Perdue v. Crocker Bank* (1985) 38 Cal.3d 913, " '[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863. . . . In only a few instances has Congress explicitly preempted state regulation of national banks. More commonly, it has been left to the courts to delineate the proper boundaries of federal and state supervision [¶] The judicial test has been a tolerant one. [National banks'] right to contract, collect debts, and acquire and transfer property are all based on state law.' [Citation.] Thus the rule is that state laws apply. . . . " (*Id.* at p. 937, quoting *National State Bank, Elizabeth, N.J. v. Long* (3d Cir. 1980) 630 F.2d 981, 985.)

The California statute nominally at issue in this case – section 1671, subdivisions (c) and (d), of the Civil Code – can hardly be said to fail to pass constitutional muster under the governing test. Certainly on the basis of the

text of section 30 alone, Congress's intent to displace credit terms other than interest rates applicable to out-of-state national banks is far less than "clear and manifest." Even more pronounced is the failure of Citibank – which bears the burden of demonstrating federal preemption (see *Perdue v. Crocker Bank, supra,* 38 Cal.3d at p. 937) – to establish that application of California's ban on late charge fees unrelated to actual damages will in any sense "incapacitate" it from carrying out its duties as a federal instrumentality.

CONCLUSION

Professor Geoffrey Miller, an authority on the American banking system and its history, commenting on the revolution sweeping the industry, has observed that "It is sobering, if edifying, to realize that banking, the world's most regulated industry, is evolving in almost blithe disregard of regulatory constraints. The industry has changed through the use of previous dormant statutory powers, through the aggressive manipulation of loopholes, or (sometimes) in apparent disregard of well-established legal principles. But legislators and the regulators have not forced the action. They have been relegated to cleaning up after the party – closing loopholes, ratifying changes that have occurred extralegally, or removing regulatory constraints in order to allow banks and thrift institutions to survive competition from their unregulated rivals. 'Deregulation' has indeed taken place, but it has not been the result of deliberate policy initiatives on the part of the legislative or executive branches." (Miller, *Interstate Banking in the Court, supra,* 1985 Sup. Ct. Rev. at p. 180.)

It is difficult to imagine a more classic example of this diagnosis than the case before us. Late payment charges exacted by credit card issuing banks totaled almost $2 billion in 1992, according to one industry source. (Credit Card News (Apr. 1, 1994) at p. 2.) A large part of this revenue, from what one authority has called the "massive interstate credit card exportation phenomenon," has gone to Citibank, easily the dominant credit card issuer in the interstate market, by exploiting what can only be called a loophole in the interstices of federal-state banking regulation. (See Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions, supra,* 42 Bus. Law. at p. 936; see also the study, General Accounting Office, U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored (Apr. 1994) p. 27 [Citibank is the single largest issuer of Visa and Mastercard with over $35 billion in billings.].)

However valuable to the economy of South Dakota, that scheme is in derogation of the right of the California Legislature to ensure the welfare of its residents in their credit dealings, more or less as it sees fit. To paraphrase the high court's opinion in *Marquette, supra,* 439 U.S. at page 319, "any plea to alter § [30] . . . is better addressed to the wisdom of Congress than to the judgment of this Court." It is not for us to condone an evasion of California's laws or the primacy of its law making powers by the judicial legerdemain embraced by the majority.

ARABIAN, J.

DISSENTING OPINION BY GEORGE, J.

I respectfully dissent.

The question before us is whether federal law precludes California from applying its state consumer protection laws to *late-payment charges* imposed upon California consumers by a national bank that is chartered in another state but is doing business in California. As I shall explain, I believe that the majority, in concluding that federal law prohibits the application of California law to such late-payment charges, has failed to recognize the clear distinction that traditionally has been drawn between such late-payment charges and charges that commonly are characterized as "interest."

I

In analyzing the question before us, it is helpful to begin by placing the matter in perspective. As a general rule, of course, out-of-state corporations that conduct business in California ordinarily are subject to this state's consumer protection laws. (See, e.g., *California v. ARC America Corp.* (1989) 490 U.S. 93, 101.) Furthermore, although Congress clearly possesses the authority to exempt nationally chartered banks from the general operation of state law, as we explained in *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 937, "Congress has declined to provide an entire system of federal law to govern every aspect of national bank operations . . . [and] national banks have traditionally been 'governed in their daily course of business far more by the laws of the State than of the [n]ation. . . . ' " (Quoting *National Bank v. Commonwealth* (1870) 76 U.S. (9 Wall.) 353, 362; see also

McClellan v. Chipman (1896) 164 U.S. 347, 357; *Anderson Nat. Bank v. Luckett* (1944) 321 U.S. 233, 248.) Thus, in the *Perdue* decision itself, we held that California properly could apply its state consumer protection laws in determining the invalidity of fees imposed by the defendant national bank for the processing of "bounced" or "NSF" checks (i.e., checks drawn on accounts with insufficient funds).

Although, as Perdue demonstrates, it is well established that federal law does not broadly preempt states from applying state law to the operations of national banks, at the same time it is quite clear that, under the federal statute at issue in this case (12 U.S.C. § 85 (hereafter section 85)), the *rate of interest* that may be charged on loaned funds is a subject as to which California may not apply its own state law in evaluating the validity of the actions of defendant Citibank. In *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299, the United States Supreme Court held that the State of Minnesota could not apply its own state law limits on the rate of interest (that could be charged on consumer credit card accounts) to a national bank whose home state was Nebraska. The high court concluded that, under section 85, the Nebraska national bank was entitled to impose a rate of interest authorized by Nebraska law even in its dealings with Minnesota residents. Thus, under the *Marquette* decision, it is clear that, because defendant Citibank is a national bank whose home state is South Dakota, California may not apply the limits on interest rates embodied in California law to restrict the rate of interest Citibank charges California consumers on their Citibank credit card accounts.

The *Marquette* decision, however, involved only the question of interest rates and did not address the issue whether section 85 applies to the type of late-payment fees at issue in the present case. As I shall explain, I believe that section 85, read as a whole and according to the ordinary meaning of its terms, does not support the majority's conclusion that the late-payment charges here at issue constitute "interest" within the meaning of that statute.

II

Section 85 provides in relevant part: "Any [national bank] may take, receive, reserve and charge on any loan or discount made . . . *interest at the rate* allowed by the laws of the State . . . where the bank is located, or *at a rate* of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve Bank . . . , whichever may be the greater, and no more. . . . When *no rate* is fixed by the laws of the State . . . the bank may . . . charge *a rate* not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank . . . , whichever may be the greater. . . . " (Italics added.)

Section 85 includes no special definition of the term "interest" as used in the statute, and no indication that the term was used in other than its ordinary and commonly understood sense. As numerous cases have recognized, a late-payment charge that is set at a fixed-dollar amount unrelated either to the amount of the loan or the time period for which funds are advanced, and that is assessed only if the borrower fails timely to make a

required payment, ordinarily is not considered "interest." (See, e.g., *Tackett v. First Sav. of Arkansas, F.A.* (Ark. 1991) 810 S.W.2d 927, 931-932; *Rangen, Inc. v. Valley Trout Farms, Inc.* (Idaho 1983) 658 P.2d 955, 957-960; *Barbour v. Handlos Real Est. and Bldg. Corp.* (Mich. Ct.App. 1986) 393 N.W.2d 581, 587 ($15 late-payment fee "do[es] not constitute interest"].) Unlike a loan origination fee or other charge that its imposed by a lender without regard to the subsequent conduct of the borrower and that ordinarily would be included in calculating the "effective" rate of interest at which a loan is made, a late-payment fee that is assessed if, and only if, the borrower fails to make a timely payment during the period of the loan, properly is viewed as either a "penalty" or as "liquidated damages," imposed upon the basis of conduct that is within the control of the borrower. (See, e.g., *Garrett v. Coast Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 735-742 [holding that a late charge in a home loan contract does not constitute interest but instead reasonably must be viewed as either a penalty or liquidated damages].) Such a conditional or contingent late-payment charge or assessment traditionally has been distinguished from interest for purposes of determining whether a loan has been made at a rate in excess of the permitted rate of interest. (See, e.g., *First American Title Ins. & Trust Co. v. Cook* (1970) 12 Cal.App.3d 592, 596-597 [holding that $5 late charge could not be regarded as interest on a loan for the purpose of determining whether the loan was usurious: "Whether a transaction is usurious must be determined as of the time of the transaction. An agreement which is not usurious in its inception cannot become so

by reason of the borrower's subsequent default. [Citations.] The penalty provisions as to which Cook now objects come into play only in the event of his default. Such payments are not regarded as interest on the loan itself, but as a penalty for nonperformance of a legitimate agreement. [Citation.]"]; *Fox v. Federated Department Stores, Inc.* (1979) 94 Cal.App.3d 867, 884 [holding that late-payment finance charge on credit card account is not usurious: "Since the contract at its inception does not require a usurious payment, and it is only because of the customer's voluntary act in failing to make the payment when due that a finance charge is levied, under the applicable law such charge cannot be usurious."].)

There is absolutely nothing in section 85 that suggests that Congress, when it enacted this provision in 1864, intended the statutory reference to "interest" to include the type of late-payment fee at issue in the present case. Indeed, at the time of the 1864 enactment, the leading United States Supreme Court decisions on the subject made it quite clear that such a late-payment charge, whose payment was contingent upon the borrower's own conduct during the term of the loan, would *not* be considered interest for the purpose of determining whether the loan exceeded the legally permitted rate of interest. (See *Spain v. Hamilton's Administrator* (1863) 68 U.S. (1 Wall.) 604, 626 ["*The payment of anything additional depends also upon a contingency,* and not upon any happening of a certain event, *which of itself would be deemed insufficient to make a loan usurious.*" (Italics added.)]; *Lloyd v. Scott* (1830) 29 U.S. (4 Pet.) 205, 224 ["If a party agree to pay a specific sum, exceeding the lawful interest, provided he do not pay the principal by a day certain, *it is*

not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, which is considered as a penalty." (Italics added.)].) Although the majority cites a few, isolated pre-1864 cases that held that, under some circumstances, such charges might be viewed as rendering a loan usurious (see maj. opn., *ante,* at p. ___ [typed maj. opn. at p. 18]), the very annotation cited by the majority states explicitly and unequivocally that "the general rule" at that time (and thereafter) was to the contrary, and corresponded to the above quoted statements of the United States Supreme Court in the *Spain, supra,* 68 U.S. 604, and *Lloyd, supra,* 29 U.S. 205, decisions. (See Annot. (1933) 82 A.L.R. 1213, 1214.) Under these circumstances, I believe it is unreasonable for the majority to conclude that, when enacted, the term "interest," as employed in section 85, was intended to encompass the late-payment charges here at issue.[1]

[1] Although the majority acknowledges that the *Spain, supra,* 68 U.S. 604, and *Lloyd, supra,* 29 U.S. 205, decisions indicate that a late-payment charge generally would not be considered in determining whether a lender had charged a usurious rate of interest, the majority suggests that those decisions are not inconsistent with its interpretation of section 85 because they do not indicate that a late-payment fee should not be considered "interest," but rather simply indicate that a late-payment fee should not be considered "unlawful interest." (Maj. opn., p. ___, fn. 8 [typed maj. opn. at pp. 18-19, fn. 8].) I believe the majority's suggestion reflects an unreasonable interpretation of the word "interest" as used in section 85. In my view, in providing in section 85 that a national bank may charge on any loan "interest at the rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank . . . , whichever is greater," Congress clearly was referring to those charges imposed by a national bank that were subject to and limited by laws establishing legal "rates of interest," and was not referring to other charges or fees that generally were not subject to the legal limitations imposed upon interest rates.

The conclusion that the term "interest," as employed in section 85, should not be interpreted to encompass late-payment charges is further supported by the circumstance that other federal statutes and regulations draw a clear distinction between interest and late-payment charges or fees. (See, e.g., 12 C.F.R. §§ 226.4(b)(1), 226.4(c)(2) (1995) (implementing 15 U.S.C. § 1605(a)(1)) [under federal Truth in Lending Act, "finance charge" includes "interest" but excludes "[c]harges for actual unanticipated late payment"]; 12 C.F.R. § 590.3 (1995) (implementing 12 U.S.C. § 1735f-7a) [with respect to federally related mortgage loans, state laws "expressly limiting the rate or amount of interest . . . shall not apply," but "[n]othing in this section preempts limitation in state laws on . . . late charges. . . . "]. See also *Seiter v. Veytia* (Tex. 1988) 756 S.W.2d 303 [federal statute eliminating interest rate limitations on loan secured by first liens on residential real property did not include late charges, and thus federal statute did not preempt application of sate law to such late charges].)

III

The majority maintains, however, that the term "interest" in section 85 must be given an unusually broad interpretation, encompassing late-payment fees, in order to effectuate the legislative purpose of the statute. It reasons: "If 'interest' were not read as indicated above, the purpose of facilitating a national banking system by granting national banks 'most favored lender' status in their home states could be frustrated by unfriendly state legislation. Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks,* but fix them at a rate so low that they could lend only at a loss. It might then allow late

payment fees to some lenders, *not including national banks,* at a level high enough that *they* could lend at a profit. Such a result would be untenable." (Maj. opn., *ante,* at p. ___ [typed maj. opn. at p. 20], original italics, fn. omitted.)

In my view, the foregoing reasoning of the majority is flawed in two distinct respects. First, I do not believe it is accurate to suggest that if section 85's reference to "interest" were interpreted *not* to include late-payment charges, a home state would be free to discriminate against national banks with regard to the imposition of such late fees. It has been quite well settled, since the early 1800's, that – even in the absence of a specific federal statutory prohibition – a state may *not* discriminate against a "federal instrumentality" either in the enactment or the enforcement of state laws, and a national bank, of course, is a federal instrumentality. (See *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316; *Farmers' and Mechanics' National Bank v. Dearing* (1875) 91 U.S. 29; *Memphis Bank & Trust Co. v. Garner* (1983) 459 U.S. 392, 397.)

Furthermore, if, absent the application of section 85, a home state lawfully *could* discriminate against a national bank (vis-a-vis its local state banks or other lenders) and desired to do so, a state would be able to discriminate with regard to a great variety of matters – from building permits to minimum wages to health and safety requirements – and yet no one reasonably could maintain that all of these matters should be characterized as "interest," within the meaning of section 85, simply because they are susceptible to discriminatory application. Thus, even if a state theoretically would be free (apart from section 85) to discriminate against a national

bank with regard to late-payment charges – a proposition I do not accept – that circumstance still would provide no logical basis for characterizing such charges as "interest" within the meaning of section 85.

Accordingly, I believe the majority has failed to demonstrate that the legislative purpose of section 85 justifies a departure from the ordinary reading of the statutory term "interest."[2]

IV

In sum, I conclude that the word "interest," as employed in section 85, cannot properly be interpreted to apply to the late-payment charges at issue in this case. Of course, if Congress determines, as a matter of policy, that the validity of late-payment charges imposed by a national bank should be determined by the law of the national bank's home state, it may extend section 85 to

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[2] I recognize that the majority's expansive interpretation of the word "interest," as employed in section 85, follows the lead of a number of lower federal and sister-state courts. (See maj. opn., *ante,* at p. ___ [typed maj. opn. at p. 24].) In *Greenwood Trust Co. v. Com. of Mass.* (1st Cir. 1992) 971 F.2d 818, perhaps the leading case in this line of decisions, the court relied upon a number of prior cases broadly interpreting section 85 to apply to a variety of bank charges or fees other than late-payment fees, and did not consider specifically whether, when the predecessor to section 85 was enacted in 1864, the statutory reference to "interest" was intended to encompass late-payment fees, as contrasted with the many other possible types of bank charges. (See 971 F.2d at pp. 829-830.) In any event, to the extent that prior decisions conclude that the term "interest," as employed in section 85, was intended to refer to such late-payment charges, I respectfully disagree for the reasons set out above.

reach such late-payment charges. As currently written, however, I believe that the statute does not apply to such charges.

For the foregoing reasons, I would reverse the judgment of the Court of Appeal and permit plaintiff's action to go forward.

GEORGE, J.

ORDER GRANTING REVIEW
AFTER JUDGMENT BY THE COURT OF APPEAL

Second Appellate District, Division Seven,
No. B078913/B077960 – S041711

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

(Filed Oct. 27, 1994)

BARBARA SMILEY, Appellant

v.

CITIBANK (SOUTH DAKOTA), N.A., Respondent

Appellant's petition for review GRANTED.
Lucas, C.J. did not participate.

____
Chief Justice

Mosk
Associate Justice

Kennard
Associate Justice

Baxter
Associate Justice

Werdegar
Associate Justice

____
Associate Justice

____
Associate Justice

BARBARA SMILEY, Plaintiff and Appellant, v. CITIBANK (SOUTH DAKOTA) N.A., Defendant and Respondent.

Smiley v. Citibank

No. B078913.

COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT, DIVISION SEVEN.

26 Cal. App. 4th 1767; 1994 Cal. App. LEXIS 710; 32 Cal. Rptr. 2d 562; 94 Cal. Daily Op. Service 5333; 94 Daily Journal DAR 9751

July 11, 1994, Decided

SUBSEQUENT HISTORY: As Modified August 11, 1994.

PRIOR HISTORY: Superior Court of Los Angeles County, No. BC059202, Melvin B. Grover, Judge.

DISPOSITION: The judgment is affirmed.

COUNSEL:

Chimicles, Jacobsen & Tikellis, Nicholas E. Chimicles, Michael D. Donovan, Chimicles, Jacobsen & Tikellis, Eugene Mikolajczyk and Patrick J. Grannan for Plaintiff and Appellant.

Shearman & Sterling, William M. Burke, Richard B. Kendall and Michael H. Strub, Jr., for Defendant and Respondent.

JUDGES: Opinion by Staniforth, J.,* with Lillie, P. J., concurring. Separate dissenting opinion by Johnson, J.)

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* Retired Associate Justice of the Court of Appeal, Fourth District, sitting under assignment by the Chairperson of the Judicial Counsel.

OPINION BY: STANIFORTH, J.*

OPINION:

Appellant Barbara Smiley's (Smiley) class action seeks damages and injunctive relief alleging defendant Citibank (South Dakota) N.A. (Citibank)[1] charged excessive late charges on her (and others) Mastercard and Preferred Visa credit card accounts. Smiley alleges the fees charged are impermissible under California law. Citibank contends Smiley's claims are "completely preempted under federal law."

The trial court first denied Citibank's motion to dismiss, and Citibank then sought a writ of mandate in this court (Division Seven). This court issued its order and alternative writ of mandate directing the trial court to vacate its prior minute order denying Citibank's motion or to show cause why it did not do so. The trial court responded by entering judgment on the pleading and dismissing Smiley's action. Smiley appeals the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

Citibank is a national banking association chartered by the United States Office of the Controller of Currency (OCC). Citibank issues credit cards to customers nationwide from its sole location in Sioux Falls, South Dakota.

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* Retired Associate Justice of the Court of Appeal, Fourth District, sitting under assignment by the Chairperson of the Judicial Counsel.

[1] The complaint seeks both injunctive relief and damages and asserts causes of action under section 17200 of the California Business and Professions Code, section 1671 of the California Civil Code (which relates to liquidated-damages provisions), and California common law.

In addition to the "finance charge" on certain outstanding balances, Citibank's credit card agreements provide for "late charges" for customers who do not make minimum payments by certain specified dates.

Citibank charges are consistent with the express terms of Smiley's card agreements with Citibank. These charges are authorized under South Dakota law, where Citibank is located and where Smiley's account is maintained.

In August 1992, Citibank removed Smiley's action to the United States District Court for the Central District of California, upon the sole ground of diversity of citizenship. Citibank later sought to amend its removal petition to include the ground that Smiley's claims were preempted under federal law. Citibank filed its answer and affirmative defenses in federal court, denying every allegation of wrongdoing asserted by Smiley.

The federal court granted Citibank's motion to remand on the ground of lack of diversity. The federal court denied Citibank's motion to amend the removal petition as untimely. It therefore did not reach the merits of Citibank's preemption argument.

After remand, Citibank moved the trial court for a judgment on the pleadings dismissing with prejudice and without leave to amend all claims set forth in the complaint. The trial court denied Citibank's motion.

Thereafter, Citibank filed a petition for writ of mandate and other appropriate relief in this court (Division Seven) seeking an order commanding the trial court (1) to vacate its order denying Citibank's motion, and (2) to

enter a new order granting the motion. This court (Citibank v. Superior Court (Sept. 23, 1993) B077960 [nonpub. opn.]) issued an order and alternative writ of mandate commanding the trial court to vacate its prior minute order denying Citibank's motion or, in the alternative, to show cause why it had not done so. The trial court vacated its previous order and issued its judgment of dismissal from which Smiley filed this appeal.

The trial court held that section 85 of the National Bank Act of 1864 governs Citibank's late payment fees on credit card accounts and that Smiley's claims, all of which were based entirely on challenges to Citibank's late charges under California law, were preempted.

ISSUE

Does section 85 of the National Bank Act, 12 United States Code Annotated section 85, govern late payment fees that are charged by a national bank on credit card accounts, preempting any claim alleging that such charges violate the law of the state where the borrower resides?

I

DISCUSSION

Section 85 of the National Bank Act provides in relevant part: "Any association may take, receive, and charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located,

or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater. . . . " (*12 U.S.C.A. § 85*; hereafter section 85.)

Section 86 of the National Bank Act provides in part: "The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 86 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid. . . . " (*12 U.S.C.A. § 86*; hereafter section 86.)

Neither section 85 nor 86 defines the terms "interest" and "rate of interest". Smiley claims that late fees are not governed by sections 85 and 86. She argues that sections 85 and 86 govern the amount of interest national banks may charge and that because late fees are not interest, they are not governed by sections 85 and 86.

Multiple courts in interpreting sections 85 and 86 have treated a wide variety of charges as interest within the meaning of the statute. (See *Fisher v. First Nat. Bank of Omaha (8th Cir. 1977) 548 F.2d 255* [cash advance fee]; *McAdoo v. Union Nat. Bank of Little Rock, Arkansas (8th Cir. 1976) 535 F.2d 1050, 1056* [compensating balance requirements]; *Cronkleton v. Hall, (8th Cir. 1933) 66 F.2d 384, 387*, cert. den. (1933) *290 U.S. 685 [78 L.Ed. 590, 54 S. Ct. 121]* [bonus or commission paid to lender]; *Northway Lanes v.*

Hackley Union Nat. Bank & Trust Co. (8th Cir. 1972) 464 F.2d 855, 863 [closing costs]; *Schumacher v. Lawrence (6th Cir. 1940) 108 F.2d 576, 577* [taxes and recording fees]; *Panos v. Smith* (6th Cir. 1940) 116 F.2d 445 [same]; *American Timber & Trading v. First Nat. Bank of Ore. (9th Cir. 1982) 690 F.2d 781* [compensating balance requirements]; *Nelson v. Citibank (South Dakota) N.A. (D.Minn. 1992) 794 F. Supp. 312, 318; Ament v. PNC Nat. Bank (W.D.Pa. 1992) 825 F. Supp. 1243.)*

In *Fisher v. First Nat. Bank of Omaha, supra, 548 F.2d 255*, the court concluded that because section 85 allowed national banks located in Nebraska to charge interest at the rate allowed by state law, and because Nebraska law allowed some classes of state lenders to charge flat fees for loans, national banks located in Nebraska could also charge flat fees for loans. In its May 28, 1992 order, this Court held that under Fisher, interest under section 85 could not be defined narrowly to include only periodic interest charges, but included flat fees as well.

The United States Supreme Court upheld the Fisher court's holding in *Marquette Nat. Bank v. First of Omaha Corp. (1978) 439 U.S. 299 [58 L. Ed. 2d 534, 99 S. Ct. 540]*. The issue in Marquette was whether a national bank chartered in Nebraska could charge its Minneapolis credit card customers an interest rate that was allowed under Nebraska law, but was higher than the rate allowed by Minnesota's usury law. The Court held that under the plain language of section 85, a national bank could charge the rate of interest allowed by the state named in its organization certificate. The fact that the bank extended credit to residents of another state, the Court reasoned, did not alter the bank's location. *(Marquette, 439 U.S. at p.*

310 [58 L. Ed. 2d at p. 543].) Because section 85 allowed the bank to charge the interest allowed by Nebraska law, it overrode Minnesota's interest rate ceilings.

In *Marquette Nat. Bank v. First of Omaha Corp., supra, 439 U.S. 299, 308 [58 L. Ed. 2d 534, 541-542]*, the United States Supreme Court stated: "Omaha Bank is a national bank; it is an 'instrumentalit[y] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.' *Davis v. Elmira Savings Bank, 161 U.S. 275, 283 [40 L.Ed. 700, 701, 6 S. Ct. 502]* (1896). The interest rate that Omaha Bank may charge in its BankAmericard program is thus governed by federal law. See Farmers' & Mechanics' Nat. Bank v. Dearing, 91 U.S. [(1 Otto.)] 29, 34 [*23 L.Ed. 196, 198, 199*] (1875)."

II

Citibank's authority to engage in the banking business and, specifically, to establish credit card accounts, is based on the National Bank Act. *(12 U.S.C.A. § 24* (Seventh); 12 C.F.R. § 7.7378 (1994).) The Act establishes a federal limit on lending charges by national banks (§ 85). If the section 85 limit is exceeded, section 86 provides the borrower's exclusive remedy: forfeiture of all interest due on the debt or, if the lender has already received the excessive interest, twice the amount of interest paid by the borrower. Thus sections 85 and 86 "cover the entire subject" of national bank lending. *(Farmers' & Mechanics' Nat. Bank v. Dearing (1875) 91 U.S. (1 Otto.) 29, 32, 35 [23 L.Ed. 196, 198, 199.)* As noted above, section 85 of the act further provides that national banks may charge "interest

at the rate allowed by the laws of the State Territory, or District where the bank is located." *(12 U.S.C.A. § 85.)* (Italics added.) Borrowers in California have a choice. They may elect to borrow money from a bank located in California or they may elect to borrow money from a bank located in a state other than California. If a borrower chooses to borrow money from a national bank located in a state outside of California, that national bank may assess the lending charges permitted by the laws of the state where it is located, even if the amount of such charges exceeds the amount permitted by California law, because California law is preempted. (See *Marquette Nat. Bank v. First of Omaha Corp., supra, 439 U.S. at p. 308 [58 L. Ed. 2d at pp. 541-542].)*

III

Twenty-four courts that ruled on the merits of the federal preemption defense raised by Citibank in this case have concluded that credit card late charges are "interest" governed by section 85.

In *Greenwood Trust Co. v. Com. of Mass. (1st Cir. 1992) 971 F.2d 818, 830-831*, cert. den. (1993) ___ U.S. ___ *[122 L. Ed. 2d 138, 113 S. Ct. 974]*, the First Circuit held that both section 85 and the parallel federal statute governing state chartered banks insured by the Federal Deposit Insurance Corporation preempt Massachusetts law prohibiting late charges.

In *Tikkanen v. Citibank (South Dakota) N.A. (D. Minn. 1992) 801 F. Supp. 270, 278-279*, the court held that Citibank's late payment charges and over-credit-limit charges "are interest within the meaning of section 85

. . . [and that] Minnesota laws regarding late and overlimit fees cannot be enforced against national banks located in other states." (Italics mine.)

In *Hill v. Chemical Bank (D.Minn. 1992) 799 F. Supp. 948* the district court held federal question jurisdiction existed because section 85 and federal statute governing lending by state-chartered banks apply to late and overlimit charges. In *Nelson v. Citibank (South Dakota) N.A., supra, 794 F. Supp. 312,* the court held that federal question jurisdiction existed because Citibank's late payment charges are interest governed exclusively by section 85. (See also *Goehl v. Mellon Bank (DE) (E.D.Pa 1993) 825 F. Supp. 1239; Ament v. PNC Nat. Bank, supra, 825 F. Supp. 1243.*)

IV

Smiley's contention that California law should govern the permissibility of the late fees here at issue is directly contrary to the OCC's longstanding interpretation that section 85 mandates such matter is governed by the law of the state of the card-issuing bank. In addressing the very issue here presented, the OCC has repeatedly concluded that late fees are governed by section 85. (Statement of Interest of the United States at p. 7, citing letter from Robert Serino, OCC, Deputy Chief Counsel (Policy) p. 2 (Aug. 11, 1988-1989).)

The OCC is the exclusive administrator of the National Bank Act, and its interpretations of that Act are entitled to substantial deference. *(Nelson v. Citibank (South Dakota) N.A., supra, 794 F. Supp. 312, 319; Clarke v. Securities Industry Assn. (1987) 479 U.S. 388, 403-404 [93 L. Ed.*

2d 757, 771, 107 S. Ct. 750]; Independent Bankers Ass'n of America v. Clarke (8th Cir. 1990) 917 F.2d 1126, 1128-1129.) This deference is particularly appropriate because national banks rely on the OCC's guidance. (See *Zenith Radio Corp. v. United States (1978) 437 U.S. 443, 457-458 [57 L. Ed. 2d 337, 347-348, 98 S. Ct. 2441]; Independent Bankers Ass'n v. Marine Midland Bank (2d Cir. 1985) 757 F.2d 453, 461,* cert. den. (1986) *476 U.S. 1186 [91 L. Ed. 2d 554, 106 S. Ct. 2926].*)

V

Smiley's reliance upon *Perdue v. Crocker National Bank (1985) 38 Cal.3d 913 [216 Cal.Rptr. 345, 702 P.2d 503]* is inapposite. The case is not in point. It does not involve section 85, or lending charges, or the preemptive scope of section 85.

In Perdue, the plaintiff filed a class action challenging the validity of charges imposed by Crocker National Bank (Crocker), a national bank located in California, for processing checks drawn on accounts without sufficient funds. *(38 Cal.3d at p. 920.)* Thus, the charges at issue in Perdue were not lending charges; they were charges associated with the bank's taking and receiving of deposits. Defendant bank was not an out-of-state bank but located in California. Consequently, the bank did not argue section 85 preempted California law. (See *Ament v. PNC Nat. Bank, supra, 825 F. Supp. 1243, 1250.*)

Similarly, not in point, are *People ex rel. Sepulveda v. Highland Fed. Savings & Loan (1993) 14 Cal.App.4th 1692, 1709 [19 Cal.Rptr.2d 555]; Garrett v. Coast & Southern Fed. Sav. & Loan Assn. (1973) 9 Cal.3d 731 [108 Cal.Rptr. 845,*

511 P.2d 1197, 63 A.L.R.3d 39]; and *Beasley v. Wells Fargo Bank (1991) 235 Cal. App. 3d 1383 [1 Cal.Rptr.2d 446]*. Like the bank in Perdue, the banks in Garrett and Beasley were located in California. None of these cases addressed either preemption or section 85. Smiley cites those cases for the irrelevant proposition that Citibank's late charges violate California law. That question is, of course, not before the court, because the sole issue before the court is whether that California law is preempted.

We conclude the late charges here are governed solely by 12 United States Code Annotated sections 85 and 86. California law purporting to regulate such charges is preempted.

The judgment is affirmed.

Costs on appeal are awarded to respondent.

Lillie, P.J., concurred.

DISSENT BY: JOHNSON, J.

DISSENT:

I respectfully dissent.

For me, this is a more difficult case than the majority opinion might suggest. The authority holding late fees are "interest" under the National Bank Act (*12 U.S.C. § 85*, hereafter section 85) is thin and far from settled. Indeed it consists primarily of a single First Circuit case decided just two years ago, which, in turn, has been

followed by a few district court judges.[1] I am skeptical about the convoluted reasoning of the First Circuit opinion. Since a California appellate court is not bound by federal circuit court or district court opinions as to interpretations of federal law,[2] in my view this court should consider the language of section 85 anew and in doing so, reach a sensible definition of "interest." Under the construction the majority opinion accepts it is "caveat emptor" and a prayer for California consumers who sign up for credit cards issued by non-California banks.

The *Greenwood Trust Co. v. Com. of Mass. (1st Cir.1992) 971 F.2d 818* (Greenwood) opinion employs a railroad metaphor, beginning with the first sentence. "This train wreck of a case arises out of a headlong collision between a state consumer-protection law and a federal banking law." (*971 F.2d at p. 821*.) Several pages later the train ride ends. "We need not grease the rails. . . . Given the imperatives of the Supremacy Clause, the whistle sounds loud and clear. The [state consumer protection law] must yield. It is preempted." (at pp. 830-831.)

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[1] See, e.g., *Tikkanen v. Citibank (South Dakota) N.A. (D.Minn. 1992) 801 F. Supp. 270, 278*. *Ament v. PNC Nat. Bank (W.D.Pa. 1994) 849 F. Supp. 1015* (removal to federal court ordered of lawsuit seeking recovery of excess interest and various fees and charges, including late fees); *Grunbeck v. Dime Sav. Bank of New York, FSB (D.N.H. 1994) 848 F. Supp. 294*.

[2] California Courts of Appeal are bound by decisions of the United States Supreme Court and of the California Supreme Court interpreting federal law. But they are not bound by circuit or district court decisions, although obviously those decisions are persuasive authority on federal questions. (9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, §§ 779-780 pp. 750-751.)

Taking a ride on the First Circuit's railroad I don't hear the whistle at all. Maybe that's because there is no collision between California's consumer-protection law governing late fees and federal banking law, since the federal banking law is on another track. It is speeding down the "interest" track, while this state's laws and judicial decisions limiting late fees are chugging up the "penalty" track. Giving out-of-state banks a clear signal to charge whatever rate of interest their home state may allow on credit cards does not mean Congress intended state governments should be precluded from regulating other aspects of credit card transactions.

Greenwood did not involve section 85 of the banking law, directly. Greenwood Trust Company is not a federal bank governed by the national bank laws. Rather it is a state banking corporation chartered in Delaware. It markets a credit card, the "Discover Card," throughout the nation. Delaware law allows credit card companies to impose substantial late fees. Massachusetts, where a hundred thousand Discover Card customers reside, does not. When the Massachusetts government threatened a lawsuit, Greenwood countered with a complaint seeking to declare that federal law preempted the Massachusetts prohibition.

The federal law Greenwood Trust sought to invoke was a recent enactment seeking to place state financial institutions on an equal footing with federal financial institutions – section 521 of the Depository Institutions Deregulation Act of 1980 (DIDA). In the provision governing allowable interest rates, this new law tracked the language of section 85. The First Circuit initially held the identical language in the two statutes meant the same

thing. Then the court used section 85 and cases interpreting it to guide its construction of section 521 of DIDA. So the Greenwood opinion only deals with section 85 indirectly.

The First Circuit had to concede there were no published cases construing "interest" to include "late payment fees" under section 85. Furthermore, the court faced a further problem. "Interest at the rate allowed" – the language within section 85 under which it sought to place "late payment fees" – has a narrower meaning in common parlance. When someone is asked what interest rate they are paying on a loan, they respond "ten and a half percent" or "seven and three eighths percent." If it is a real estate loan, they might answer "ten and a half, and two points" (the up-front interest to obtain the loan). They might even add in the closing costs and appraisal fees, etc., the lender charged as part of the "interest" paid to obtain the funds.

But common citizens are unlikely to think of the "rate of interest" as including "late payment fees" they will not incur, unless and until they fail to make timely payments, as a part of the "interest" they are paying to obtain the loan. Instead late payment fees are costs, such as those which might accompany an attachment or foreclosure, which are contingent on a failure of performance on the part of the borrower. They are not what the ordinary citizen thinks of as part of the "rate of interest."

If the term "interest rate" (or "rate of interest") is given this common sense meaning within the context of section 85, that section clearly does not apply to "late

payment fees." As a consequence, section 85 which preempts state consumer protection laws only as to the "interest rate" out-of-state federal banks can charge would not preempt those state laws as to the "late payment fees" those banks can impose on delinquent borrowers.

In an effort to avoid the result dictated by the common meaning of "interest" and "rate of interest," the Greenwood opinion attempts to suggest Congress meant those terms to have a different, more technical, and broader meaning in section 85. The court does not delve into legislative history to prove this intent, however.[3]

[3] The legislative history of the National Bank Act appears to lean in the opposite direction from the Greenwood definition of "interest." Congress did not write section 85 on a clean slate. The lawmakers chose to use the term "rate of interest" in section 85 at a time when the settled federal common law definition of "interest" specifically excluded contingent payments such as late fees. (*Lloyd v. Scott (1830) 29 U.S. [9 Pet.] 205, [7 L.Ed. 833]* [agreement to pay fixed additional payment if late in repaying loan is not considered "interest" but a "penalty"]; *Spain v. Hamilton's Administrator (1863) 68 U.S. [1 Wall.] 604, 626, [17 L.Ed. 619, 625-626]* [any payment which is contingent upon happening of an uncertain event is not part of "interest" and thus does not make a loan usurious].)

Not surprisingly, given the common understanding of the term "rate of interest", appellant's brief reports without contradiction from respondent, that the congressional debates are sprinkled with references to the "rate of interest" as solely a charge for money over time, with no mention of late charges or other contingent payments. Typically, a California congressman explained during the debate, "In California, the interest is by law, where no rate is expressed in the contract, ten percent per annum." (Cong.Globe, 38th Cong., 1st Sess. 1353 (1864).) Respondents refer us to nothing in the entire debate intimating the national lawmakers were seeking to affect state regulation of late charges or other contingent fees. Nor do they point to anything in the debate suggesting Congress intended to adopt a definition of "rate of interest" which deviated from the common law definition the Supreme Court had reiterated only two years before congressional consideration of the National Bank Act. (38 Cong. Globe, 38th Cong. 1st Sess. 2122-2124.)

Instead it turns to a couple of dictionary definitions, both of which define "interest" as " ' . . . a charge for borrowed money[,] generally a percentage of the amount borrowed.' " (*971 F.2d at p. 824*, quoting Webster's Ninth New Collegiate Dict. (1989) p. 630 [italics supplied by Greenwood court].)[4] The Greenwood court emphasizes that according to these dictionary definitions the common notion interest is a percentage of the amount loaned is only "generally" true. The court then assumes Congress intended the dictionary definition rather than what the term "rate of interest" might mean in common parlance – without even mentioning what definition of "interest" or "rate of interest" might have appeared in dictionaries more than a century ago when Congress first enacted section 85. From its finding Congress intended the dictionary definition of "interest," the Greenwood court then leaps to the conclusion the term "interest" in that statute can embrace "late payment fees."

[4] The Greenwood opinion also cited but did not quote from the definition found in Black's Law Dictionary (6th ed. 1990). Black's defines interest as "the compensation . . . fixed by the parties for the use . . . of money." (Black's Law Dict. (5th ed. 1979) p. 729.) Interest is defined in Webster's Third New International Dictionary, Unabridged (1981) page 1178 as "the price paid for borrowing money generally expressed as a percentage of the amount borrowed paid in one year."

I will turn momentarily to the question of how the court justifies its conclusion the term "interest" in section 85 does include "late payment fees." But for now I question the reasoning employed to argue the dictionary definitions on which the Greenwood court relies even allows such a construction. Forgetting about whether "interest" inevitably must be expressed as a percentage of the amount borrowed, under these dictionary definitions the essential nature of "interest" remains. It is the "price paid" or "compensation received" for the use of money obtained for a period of time from the lender. Just because this price can be expressed as a flat fee instead of a percentage of the amount borrowed, or can be expressed as a mix of percentage and flat fee charges, or perhaps in some other imaginative way, does not alter its fundamental character as an amount of money the borrower pays the lender in return for the use of a sum of money the borrower receives.

A "late payment fee," on the other hand, is not a part of the compensation borrowers pay for the use of money. Black's Law Dictionary (incidentally one of the sources of the Greenwood court's definition of "interest") contrasts the two. "Interest" is "compensation . . . for the use . . . of money." (Black's Law Dict. (5th ed. 1979) p. 729, col. 2.) A "late payment fee," on the other hand, is "compensation for delay in payment." (at p. 730, col. 1.) Black's also points out a late payment fee "in essence is in the nature of a penalty." (Ibid.) "Late payment fees" likewise have been considered a "penalty" by the California Supreme Court. (*Garrett v. Coast & Southern Fed. Sav. & Loan Assn. (1973) 9 Cal.3d 731, 739-740 [108 Cal.Rptr. 845, 511 P.2d 1197, 63 A.L.R.3d 39].*)

A "late payment fee" is a contingent obligation most borrowers will never have to pay. It is one of several consequences borrowers may face for various breaches of their contract to repay the loan and the interest on the loan (which, in turn, is the compensation owed for use of the money). Depending on the nature of the loan and the contract, those consequences may include attachment of property, foreclosure of real estate, etc. Those consequences also may include payment of various additional fees and costs – not just "late payment fees," but the lender's legal fees and collection costs, the costs of the attachment or foreclosure, etc.

Are these additional contingent costs and consequences also to be considered part of "interest" within the meaning of section 85? Does this federal law preempt state regulation of those contingent costs and consequences, too? The logic of the Greenwood opinion would say yes. But I think not, for the reason they, like "late payment fees," are not part of the "compensation for the use of that money." These charges, like the "late payment fee," are in the nature of "damages" or "penalties" for breaching the loan contract rather than "compensation" due as part of the performance of that contract.

Since I do not consider the term "interest" within section 85 even encompasses "late payment fees," in my view this section would not authorize federal preemption of state laws regulating late payment fees. Thus, ordinarily I would not reach the rest of the Greenwood rationale. Or, to put it another way, if my view represents a proper construction of the term "interest" the remaining arguments in the Greenwood opinion are irrelevant. Those arguments cannot rescue the day for preemption if

Congress indeed intended to define "interest" either in its everyday meaning on the street or as its dictionary definitions are interpreted in this dissent.

But I do have some problems with the rest of the Greenwood rationale as well. Once having posited Congress intended some sort of open-ended definition of "interest" the court urges two alternative reasons for determining "late payment fees" are included in that definition. First, according to this opinion, under section 85 the home state of the bank not only determines the rate of interest its federal banks may charge in other states, it also defines the meaning of the term "interest." If that home state decides "interest" includes "late payment fees," then "late payment fees" are interest under section 85. Consequently, the home state's law broadly interpreting interest to include late payment fees preempts other states from regulating the late fees the federal banks based in that home state charge citizens of these other states on any loans, including credit cards, those federal banks arrange with their out-of-state customers. (*721 F.2d at pp. 828-829.*)

The Greenwood court points to no authority supporting this novel interpretation of section 85. I find it unnecessary to discuss the grave issues of unconstitutional delegation of Congressional power to state legislatures this construction raises. That is because, in my view, it appears highly unlikely Congress intended to leave the scope of federal preemption to the whim of a host of state legislatures. It is one thing for Congress to be seen as delegating to state legislatures the power to effectively determine certain rates within a precisely defined area which Congress has defined and permitted preemption. It

is quite another for Congress to delegate to state legislatures the power to define the length and width of the area in which they will be allowed to set rates which preempt other states' regulations.[5] Without a clear and unequivocal statement of congressional intent to make the latter, rather extraordinary form of delegation, it seems difficult to argue Congress did so. If Congress has not unequivocally expressed such an intent, certainly courts should be reluctant to do the delegating for them.

This interpretation of section 85 appears dangerous as well as improbable. If states are allowed to define "interest" as broadly as they like, "late payment fees" may only be the beginning. Anything which bears on the conditions of a loan conceivably can be brought within the elastic concept of "interest" the Greenwood court implicitly endorses. So long as a state legislature is willing to define a specific loan condition as an element of "interest" for purposes of its own lending institutions, it becomes "interest" for purposes of all federal banks based in that state. Consequently, when federal banks home-based in that state distribute credit cards – or otherwise lend money – to citizens in other states, the state

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[5] This very concern was expressed when it was suggested Congress had delegated to state legislatures the power to define another term in the National Banking Act. The term in question was what constituted a "branch" of a bank. The United States Supreme Court rejected the notion Congress had left this definition affecting state jurisdiction to individual state legislatures. In doing so the high court observed that to do so would "make [state legislatures] the sole judges of their own powers." Our high court concluded Congress "did not intend such an improbable result." (*First National Bank v. Dickinson (1969) 396 U.S. 122, 133-134 [24 L. Ed. 2d 312, 320, 90 S. Ct. 337].*)

legislatures of those states are preempted from regulating that loan condition. In that way, the legislature of a small state, like South Dakota or Delaware, which is home base to a major credit card institution could use federal preemption to impose not just its interest rates but the bulk of its credit card laws across the length and breadth of the land.[6]

The Greenwood opinion, however, does not rely entirely on the argument Congress left the question of preemption's scope to 50 state legislatures. As an independent and sufficient ground, the court argues prior federal court decisions interpret the term "interest" within section 85 so broadly it can be deemed to encompass "late payment fees." The Greenwood opinion bases this conclusion on cases construing "interest" to include flat interest rates as well as percentage rates (*Fisher v. First Nat. Bank of Omaha (8th Cir. 1977) 548 F.2d 255* [fee for cash advance]); certain up-front loan fees (*Panos v.*

[6] I reemphasize a point made earlier. If the term "interest" means what this dissent urges it means in the context of section 85, then this prong of the Greenwood rationale falls of its own weight. State legislatures would lack the power to define "interest" so broadly it embraced "late payment fees." Even assuming state lawmakers were empowered to define the scope of preemption by defining what they included in interest, this power obviously is limited to the boundaries of the congressional definition of that term. For reasons discussed earlier, they could not extend preemption to "late payment fees" or other contingent consequences representing damages or penalties for breaching the loan contract rather than compensation for its performance. To put it another way, they could not by fiat declare "non-interest" to be "interest" and thereby impose their version of the law throughout the country.

Smith (6th Cir. 1940) 116 F.2d 445, 446-447 [taxes and recording fees]); and bonuses or commissions paid to the lender (*Cronkleton v. Hall (8th Cir.) 66 F.2d 384, 387* cert. den. (1940) *290 U.S. 685 [78 L.Ed. 590, 54 S. Ct. 121]*).

In my view, this argument fails because it neglects a vital distinction between the payments and fees defined as "interest" in these cases and the family of costs and consequences of which "late payment fees" are a member. The former are merely different forms of "compensation for the use of money." In contrast, the latter are different forms of "damages (or penalties) for failure to timely pay." The only thing the cases the Greenwood opinion cites teach us is that "interest" can embrace "compensation for the use of money" even when the compensation comes in the form of "points" or fixed payments or commissions or expenses or in the form of flat fees of various sorts tacked on to more typical percentage interest rates. These cases do not stand for the proposition "late payment fees" and like consequences of breaching the loan contract represent "interest" within the meaning of section 85. Thus, these cases supply no support as precedent or in logic for the leap the Greenwood court, and those courts which have followed in its wake, have taken over the vast gulf which separates interest for the use of money from damages for breach of a loan contract.

Although most federal courts have followed Greenwood, at least one published District Court opinion was highly critical of its reasoning. (*Copeland v. MBNA America, N.A. (D.Colo. 1993) 820 F. Supp. 537.*) In Copeland plaintiffs filed a class action in state court, nearly identical to the instant case, challenging late fees a Delaware bank imposes on its credit card holders. The bank

removed the case to federal court and the plaintiffs moved to remand to state court. The bank resisted remand on grounds there was complete federal preemption of the lawsuit under Greenwood. The Copeland court announced it "respectfully disagrees" and granted remand to the state court.

The Copeland court was careful to point out it was ruling on the narrow issue of remand and not the possible viability of a preemption defense after remand. Nonetheless, in order to decide the remand issue, the court found it necessary to dispute much of the reasoning in Greenwood.

"Courts are to assume that the legislative purpose is expressed by the ordinary meaning of the words used. . . . Because late fees are not charged on a percentage basis, the ordinary meaning of the word interest does not include late fees.

"In Greenwood Trust, . . . the court noted that the word 'generally' in Webster's qualified the definition so as not to exclude other possible meanings. [Citation.] Therefore it concluded that the plain meaning rule did not control. (Id.) The plain meaning of a word, however, is not determined by reference to variations on its ordinary meaning, but by the ordinary meaning itself, i.e., the way it is generally used.

"Legislative history offers little assistance. . . .

" . . . .

"This court concludes that a proposition that is not obvious from the plain meaning of a statute's language, nor from the legislative history, simply cannot be

regarded as a clear manifestation of congressional intent." (*Copeland v. MBNA America, N.A., supra, 820 F. Supp. 537, 540-541.*)

The Copeland court had no occasion to do so, but could just as well have added, that preemption itself does not occur unless there is a clear manifestation of congressional intent to preempt state laws. (Cipollone v. Liggett Group, Inc. (1992) ___ U.S. ___ *[120 L. Ed. 2d 407, 112 S. Ct. 2608].*)

I recognize this dissent has been devoted almost exclusively to discussion of a single circuit court opinion. However, this Greenwood opinion presented the full case for the interpretation the majority of this court has adopted. It is the rationale which has been followed or adopted by other courts in the past two years.[7] My

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[7] The majority opinion also relies heavily on an administrative agency's interpretation that "rate of interest" in section 85 includes "late fees." (Maj. opn., ante, at p. 1773.) The office of the Controller of Currency indeed has come to that view in recent years (letter of Robert Serino, Office of the Controller of Currency, Deputy Chief Counsel (Policy)). Not that many years ago, however, the head of that same administrative office took the contrary position, ruling that under section 85 "Charges for late payments . . . are illustrations of charges which are made by some banks that would not properly be characterized as interest." (Letter of J. Saxon, Controller of the Currency (June 25, 1964).)

The current Office of the Controller of Currency interpretation does not warrant the degree of deference the majority opinion accords it for several reasons. This particular agency interpretation deals with "a pure question of statutory construction", which is a judicial prerogative and not one where administrative bodies offer special competence. (*INS v. Cardoza-Fonseca (1987) 480 U.S. 421, 446 [94 L. Ed. 2d 434, 457, 107 S. Ct.*

reasons for rejecting that case and for supporting a contrary view having been set forth in full, I urge our Supreme Court to examine this issue anew. The State of California and its citizens have much to lose by allowing the legislature of a far away state to dictate the penalties a powerful lending institution can impose on our state's consumers when they are late with a payment or otherwise violate some term of the credit card contract.

1207].) Furthermore, this agency has not been consistent in its interpretation of what is embraced in the term "rate of interest." "An agency interpretation . . . which conflicts with the agency's earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view." (at p. 446, fn. 30 [*94 L. Ed. 2d at p. 457*].) Finally, I note our Supreme Court found it quite possible – indeed most reasonable – to interpret the National Banking Act contrary to a firm Office of the Controller of Currency interpretation of disputed language. (*Perdue v. Crocker National Bank (1985) 38 Cal.3d 913, 933-937 [216 Cal.Rptr. 345, 702 P.2d 503]* app. dism. (1986) *475 U.S. 1001 [89 L. Ed. 2d 290, 106 S. Ct. 1170]*.)

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

BARBARA SMILEY, On Behalf of Herself and All Others Similarly Situated, Plaintiff, v. CITIBANK (SOUTH DAKOTA), N.A., Defendant.	Case No. BC059202 **ORDER GRANTING MOTION OF DEFENDANT CITIBANK (SOUTH DAKOTA), N.A. FOR JUDGMENT ON THE PLEADINGS** Date: September 14, 1993 Time: 9:00 a.m. Place: Department 32 (Filed Oct. 06, 1993)

On July 7, 1992, Plaintiff Barbara Smiley ("Plaintiff") filed her Complaint for Damages and Injunctive Relief (the "Complaint") in the Superior Court of the State of California in and for the County of Los Angeles against defendant Citibank (South Dakota), N.A. ("Citibank").

Citibank is a national banking association chartered by the Office of Comptroller of Currency (the "OCC"), which issues credit cards to customers nationwide from its location in Sioux Falls, South Dakota. In addition to the "finance charge" on certain outstanding balances, Citibank's credit card agreements provide for "late charges" for customers who do not make minimum payments by certain specified dates. Those late charge are assessed in the form of a fixed flat fee, or as a percentage of the customer's account balance, or both.

Plaintiff is a California resident who alleges that Citibank has assessed excessive late fees on her MasterCard and Preferred Visa credit card accounts. Although such charges are consistent with the express terms of her card agreements with Citibank and are authorized under South Dakota law, where Citibank is located and where Plaintiff's account is maintained, Plaintiff alleges that such fees are impermissible under California law. The Complaint seeks both injunctive relief and damages and asserts causes of action under section 17200 of the California Business and Professions Code, section 1671 of the California Civil Code (which relates to liquidated-damages provisions), and California common law.

On April 28, 1993, Citibank moved this Court for a judgment on the pleadings (the "Motion") dismissing with prejudice and without leave to amend all claims set forth in Plaintiff's Complaint on the ground that each of Plaintiff's state-law claims set forth in the Complaint is preempted by the National Bank Act of 1864, 12 U.S.C. § 21 *et seq*. Citibank initially noticed the hearing on the Motion for May 14, 1993. That hearing was continued to

June 22, 1993, and then continued by this Court to July 6, 1993.

On July 6, 1993, the Court heard argument on the Motion. Richard B. Kendall and Michael H. Strub, Jr., of Shearman & Sterling, appeared on behalf of Citibank. Patrick J. Grannan, of Chimicles, Burt, Jacobsen & McNew, appeared on behalf of Plaintiff. Following that hearing, on July 6, 1993, the Court entered a minute order denying the Motion.

On August 23, 1993, Citibank filed a petition for writ of mandate and other appropriate relief and a memorandum of points and authorities and exhibits in support thereof (collectively, the "Petition") with the Court of Appeal of the State of California, Second Appellate District (the "Appellate Court"). A copy of the Petition was served on and received by this Court. The Petition was assigned to Division 7 as case number B077960. By its Petition, Citibank urged the Appellate Court to direct this Court to vacate its Order denying Citibank's Motion and to enter a new and different order granting the Motion. On September 3, 1993, Plaintiff filed a memorandum of points and authorities in opposition to the Petition. A copy of Plaintiff's opposition was served on and received by this Court.

On September 7, 1993, the Appellate Court entered an Order and Alternative Writ of Mandate (the "Writ") directing this Court to vacate its July 6, 1993 Order denying Motion, and thereafter to make a new and different order granting said Motion, or, in the alternative, to show cause why the July 6, 1993 Order was proper.

In response to the Writ, this Court has carefully reviewed and considered the Petition, Plaintiff's opposition to the Petition, the memoranda of points and authorities and supporting declarations and exhibits annexed thereto submitted by the parties to this Court in support of and in opposition to the Motion, as well as the records, papers, and files in this case, and good cause appears for this Court to amend its July 6, 1993 ruling. Therefore,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that:

1. The National Bank Act, 12 U.S.C. § 85, sets forth the exclusive law governing the amount of "interest" that a national bank may charge on extensions of credit.

2. Section 85 provides that a national bank may charge "interest" on extensions of credit to customers anywhere in the nation at the rates allowed to lenders under the law of the state where the national bank is located.

3. Credit card late charges are "interest" as that term is used in section 85, and the National Bank Act therefore preempts state law to the extent that state law would affect the amount of credit card late charges that a national bank may charge.

4. Each of Plaintiff's claims set forth in the Complaint is based on a challenge to Citibank's late charges under California law. Therefore, each of Plaintiff's claims is preempted by the National Bank Act of 1864, 12 U.S.C. §§ 21 *et seq.*, and no cause of action in Plaintiff's Complaint states a legally cognizable claim for relief against Citibank.

5. For the foregoing reasons, Citibank's Motion is **GRANTED,** and all claims against Citibank in this action are dismissed with prejudice and without leave to amend.

Dated: OCT 06 , 1993

MELVIN B. GROVER
HON. MELVIN B. GROVER
JUDGE OF THE SUPERIOR COURT

Submitted by:

SHEARMAN & STERLING

/s/ Richard B. Kendall
By: Richard B. Kendall
Attorneys for Defendant
CITIBANK (SOUTH DAKOTA), N.A.

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss.:
COUNTY OF LOS ANGELES)

I, the undersigned, certify and declare that I am over the age of 18 years, employed in the County of Los Angeles, California, and am not a party to the within action; my business address is 725 South Figueroa Street, 21st Floor, Los Angeles, California 90017. On September 21, 1993, I served the foregoing document described as **[PROPOSED] ORDER GRANTING MOTION OF**

DEFENDANT CITIBANK (SOUTH DAKOTA), N.A. FOR JUDGMENT ON THE PLEADINGS on the interested parties in this action as follows:

PLEASE SEE SERVICE LIST

BY MAIL: By placing a true copy thereof enclosed in a sealed envelope, and depositing same in the United States Mail with postage thereon fully prepaid. I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postage Service on that same day with postage thereon fully prepaid in Los Angeles, California in the ordinary course of business.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at Los Angeles, California this 21st day of September, 1993.

/s/ J. J. Todd
Jeanette Todd

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
IN AND FOR THE CITY AND
COUNTY OF LOS ANGELES

(Filed July 7, 1992)

BARBARA SMILEY, On Behalf of Herself and All Others Similarly Situated,	Case No. BC059202
Plaintiff,	CLASS ACTION
vs.	COMPLAINT FOR DAMAGES AND INJUNCTIVE RELIEF
CITIBANK (SOUTH DAKOTA), N.A.,	1. Unlawful Business Practices in Violation of California Business and Professions Code § 17200
Defendant.	2. Breach of Duty of Good Faith and Fair Dealing
	3. Violation of Civil Code § 1671
	4. Unjust Enrichment and Imposition of Constructive Trust
	5. Fraud and Deceit
	6. Negligent Misrepresentation
	7. Breach of Contract and Rescission
	Plaintiff Demands A Trial By Jury

Plaintiff, on behalf of herself and all others similarly situated, makes the following allegations on information and belief (except as to ¶¶ 5-7), based upon, *inter alia*, the investigation of her counsel.

INTRODUCTION

1. Plaintiff brings this case on her own behalf and on behalf of all persons who held or currently hold a Citibank credit card, issued by defendant, while they were residents of California and while they maintained a California billing address, who have contracted for or been charged a late charge on such credit card account. Citibank has charged the plaintiff and other similarly situated persons (South Dakota), N.A. the late charges that are the subject of this action.

2. The defendant named herein advertises, markets, and/or distributes, either directly or through its subsidiaries, credit cards for which it charges exorbitant and unjustifiable late fees, and has been engaged in a long-term advertising, promotional and marketing campaign involving such cards that is false and misleading by its failure to disclose that such late charges are illegal and unconscionable. The defendant knew, recklessly disregarded and/or reasonably should have known of the impropriety of the late charges it imposed and continues to charge, but because or the heavy losses attributable to its loan portfolios, the defendant has engaged in a conspiracy to charge illegal and unconscionable late charges and to conceal from the public the impropriety of these late charges. While the defendant has attempted to assert the legitimacy of these late charges through further misrepresentations, claiming that its costs of collection have increased in recent years – primarily as a result of its own greed in indiscriminately issuing credit cards to non-creditworthy consumers during the 1980's – the defendant has failed to issue a statewide general warning about the illegality of the late charges or immediately halt the practice of imposing these exorbitant late charges, ostensibly for fear that its credit card business would generate less profits.

3. In California, there has been, until now, a virtual conspiracy of silence by the defendant – sometimes even resulting in overt misrepresentations – about the illegality and impropriety of these late charges.

4. This action seeks, among other remedies, appropriate damages and injunctive relief on a statewide basis in an effort to stop this conspiracy and the ongoing unfair

business practice conducted by the defendant, now resulting in widespread illegal and unconscionable late charges being paid by California consumers. Specifically, plaintiff challenges the imposition of certain late charges, in addition to already exorbitant interest rate levels charged for credit cards (now nearly four times the rate for a one year CD), without ensuring that such charges only equate to the actual damages incurred by this financial institution for the delinquent payment, or without providing consumers a warning as to the illegality and unconscionability of these late charges. This Complaint also seeks equitable and injunctive relief, including a statewide advertising campaign and/or a late charge refund, the imposition of a constructive trust on monies illegally obtained by the defendant, and to recover compensatory, statutory and/or punitive damages for the plaintiff class, as well as obtaining disgorgement and restitution from defendant of its ill-gotten gains for deceptive and unfair business practices unfair competition and false advertising, negligent misrepresentation, fraud and deceit, breach of contract and the covenant of good faith and fair dealing, and unjust enrichment, all resulting from defendant's conspiracy, common course of conduct and failure to disclose that the late charges it was imposing and continues to charge consumers are illegal and unconscionable.

PARTIES

5. Plaintiff Barbara Smiley is a resident of Los Angeles County, California. Plaintiff brings this action both in her individual capacity and on behalf of all others similarly situated against the named defendant. Plaintiff

was the holder of a Mastercard credit card issued by defendant at relevant times and is the holder of a Preferred Visa credit card issued by defendant. Plaintiff has been charged late charges by defendant in Los Angeles County on both her Mastercard and Preferred Visa account. In so doing, plaintiff either directly or indirectly relied upon, *inter alia* the representations, advertising, agreements and other promotional materials which were prepared and approved by the defendant and its agents and disseminated through advertising media and direct mail containing the misrepresentations and omissions alleged herein.

6. Defendant Citibank (South Dakota), N.A. ("Citibank") is a South Dakota chartered credit card bank with its principal place of business in Sioux Falls, South Dakota. Citibank is a wholly owned subsidiary of Citicorp, Inc., a bank holding company incorporated in Delaware and headquartered in New York, New York. Citibank actively solicits California residents to apply for and accept credit cards and has issued large numbers of credit cards to California residents.

7. In committing the wrongful acts alleged herein, the defendant has pursued a common course of conduct, acted in concert with, aided and abetted and conspired with other credit card issuers, in furtherance of a common plan, scheme or design to misrepresent and/or conceal the illegality and unconscionability of the late charges imposed upon California consumers, and thereafter to conceal and cover-up the wrongdoing, all for their own personal profit. Defendant actually knew of or recklessly or negligently disregarded the misrepresentations

and concealments at issue and actively participated in covering up their true effect.

JURISDICTION AND VENUE

8. This court has jurisdiction over all causes of action asserted herein pursuant to the California Constitution, Article VI, § 10, because this case is a cause not given by statute to other trial courts.

9. This court has jurisdiction over defendant Citibank because it extensively solicits California residents and merchants to use and accept Citibank credit cards and it does sufficient business in California and avails itself of the California market to render the jurisdiction of the California courts permissible under traditional notions of fair play and justice.

10. The damages suffered and sought to be recovered by plaintiff and the class she seeks to represent in the aggregate are in excess of the jurisdictional minimum of this court (although the individual claims of every class member would not exceed this amount), but the exact amount of damages caused to the class members cannot be precisely determined without access to defendant's records. The individual value of the damages and injunctive relief sought for each member of the Class is substantially less than $50,000 per person. Venue is proper in this court since plaintiff, as well as thousands of class members, entered into an agreement with the defendant or its agents or subsidiaries and otherwise engaged in the transactions which form the basis of this action by paying the late charges in question and/or by entering into an agreement for the use of the subject

credit cards distributed by defendant in Los Angeles County.

CLASS ACTION ALLEGATIONS

11. Plaintiff brings this action on her own behalf and on behalf of all other persons similarly situated. The class which plaintiff seeks to represent is composed of all persons with California billing addresses who have contracted for or been charged a late charge in connection with the use of a Citibank credit card issued by Citibank.

12. The class is composed of thousands of persons, the joinder of whom is impracticable, and the disposition of its claims in a class action will benefit both the parties and the court. The class is sufficiently numerous, since the defendant advertises, promotes, distributes and collects late charges from credit cards issued directly to California consumers.

13. There is a well-defined community of interest in the questions of law and fact involved affecting the parties to be represented. The questions of law and fact common to the class predominate over questions which may affect individual class members, including the following:

(a) Whether the defendant perpetrated a fraud upon the class or committed a breach of contract by committing the acts and omissions detailed herein;

(b) Whether the defendant knew or recklessly or negligently disregarded that the late charges it contracts for, imposes and/or collects are illegal and unconscionable;

(c) Whether the defendant knowingly, recklessly or negligently charged the late charges in question by disregarding or concealing the illegality and unconscionability of such late charges;

(d) Whether the acts of the defendant violated, *inter alia* California Business and Professions Code §§ 17200 and 17500 and California Civil Code §§ 1670.5, 1671 and 1750, *et seq.*, and other state common and statutory laws;

(e) Whether the defendant allowed the charging of illegal and unconscionable late charges under false pretenses by misrepresenting or concealing that such late charges were, in fact, illegal and unconscionable; and

(f) Whether the class has been damaged and/or suffered irreparable harm and, if so, the extent of such damages and/or the nature of the equitable and injunctive relief, restitutional, compensatory damages or punitive damages to which the class is entitled.

14. By contracting and paying the illegal and unconscionable late charges imposed by defendant, plaintiff is asserting claims that are typical of the claims of the entire class, and plaintiff will fairly and adequately represent and protect the interests of the class in that she has no interests antagonistic to those of the class. Plaintiff has retained counsel who are competent and experienced in class action litigation.

15. Plaintiff and the class have suffered irreparable harm and damages as a result of defendant's wrongful conduct as alleged herein. Absent a class action defendant will likely retain the millions of dollars received

through its wrongdoing. Because of the small size of the individual class members' claims, few, if any, class members could afford to seek legal redress for the wrongs complained of herein. Absent a representative action, the class members will continue to suffer losses, the imposition of late charges will proceed without remedy and defendant will retain the proceeds of its ill-gotten gains. Even today the defendant continues to charge illegal and unconscionable late charges, thereby receiving further revenues and profits.

16. Notice of the pendency of this action can be given either by regular mail or by publication, which cost, under California law, can reasonably be imposed upon the defendant.

FACTS

17. The defendant charges a late charge of up to $15.00 upon California consumers who use its credit cards, irrespective of the outstanding balance or amount owing on the credit card in question. This results in a substantial additional cost on the use of such cards, and is automatically imposed, even when a full payment is received just days after the initial due date.

18. There is a fundamental distinction between the interest charged by the defendant and the illegal and unconscionable late fee charges imposed by the defendant. Interest is a measure of compensation to which an obligee is entitled, while a penalty is punitive in character. The forfeiture attributable to a late charge is compelled without regard to the actual damages allegedly

sustained by the defendant as a result of the late payment, particularly when combined with the continuing exorbitant interest rate imposed by defendant on the outstanding balance. The late charges imposed upon California consumers by defendant are not calculated as the result of any reasonable endeavor by it to estimate a fair average damage that may be sustained by it as a result of the delinquency of the payment, since the late charges are assessed in addition to the continued payment of high interest and, on occasion, can practically equal the minimum payment due to the defendant, but in fact bear no relationship to the actual loss that allegedly is suffered by the defendant as a result of such late payments. The late charge imposed by defendant thus constitutes an illegal penalty in violation of California common and statutory law, including, *inter alia*, California Civil Code 1667, 1670.5 and 1671.

19. The primary purposes of these late charges are illegal – extracting from California consumers additional payments, which in actuality substantially exceed the damages allegedly suffered by the defendant, and to compel prompt payment through the threat of the imposition of charges bearing little or no relationship to the amount of the actual losses incurred by defendant. In some instances, these late charges, if calculated on an annualized basis as compared to the minimum payment due the defendant, result in additional charges which exceed 200% per annum or more. Even under the California Retail Installment Sales Act, California Civil Code § 1803.6, the maximum permissible delinquency charge that can be imposed on California consumers is $5.00 per month or 5% of the installment due, *whichever is less*, and

even then such a charge may only be imposed once per delinquent payment. For credit card late charges, even though the minimum amount payable is generally as low as $20.00 per month, the late charges imposed grossly exceed this maximum charge, and are charged each month, irrespective of whether the credit card has been used by the unsuspecting consumers, whether additional charges have been incurred in the interim, or whether the payment was simply several days late.

20. The late charges imposed by the defendant in connection with the use of its credit cards are also unconscionable. The defendant enjoys superior bargaining position over all members of the class as a result of its greater economic power, knowledge, experience and resources. Class members who are forced to utilize credit cards for the majority of their major consumer purchases have no alternative but to acquiesce in the relationship as offered by the defendant or to accept a similar, if not exact, arrangement with another bank or similar financial institution, which arrangements impose a late charge. Consumers' acquiescence to these transactions are hardly a luxury. For the person without a credit card, it is difficult, if not impossible, to rent a car, stay at a hotel, reserve tickets to a theater or sporting event, travel without excessive amounts of cash or engage in many other routine activities of modern society. Yet, despite the necessity of maintaining a credit card in our increasingly cashless society, in this totally one-sided transaction, consumers have absolutely no right to alter the relationship between themselves and the financial institutions without terminating the relationship altogether. Thus, defendant's

cardholders agreement is an adhesion contract containing unduly oppressive and unconscionable provisions.

21. The late charge imposed by the defendant is an unconscionable addition to the already exorbitant interest rates charged consumers. The great disparity between the actual cost to the defendant resulting from the alleged default and the actual amount charged by the defendant to consumers through imposition of late charges, in light of the absence of any equality of bargaining power, open negotiation, full disclosure and a contract which clearly and fully sets out the rights of the parties, unreasonably and oppressively imposes excessive and unfair liability upon the plaintiff and the members of the class, evidencing the unconscionability of the late charge provision. This has been borne out in a series of actions brought against financial institutions throughout the United States, in which such late charges have consistently been held illegal and unconscionable.

22. The defendant in its credit card advertising material and contracts does not fully, or sometimes at all, disclose the possibility of late charges, the amount of the late charge, in what circumstances late charges will be imposed, the purpose for such late charges, or that the amount of the late charge may greatly exceed the actual cost of collection. Even where there is such disclosure, it is provided in print so small that many consumers cannot read it, and is in general not provided to consumers before the consumer has even obtained the credit card. As a result, consumers are likely to be deceived by the materials disseminated by the defendant, in the defendant's attempt to obtain additional users of its profitable credit cards. Through the defendant's acts of deception,

the defendant has thus engaged in substantial acts of unfair competition.

23. The defendant has continued its practice of charging illegal and unconscionable late charges and conducting its long-term, false and misleading advertising and promotional campaign. The defendant has failed and refused to stop its illegal and unconscionable activities. In fact, the defendant charged plaintiff with late fees within the applicable limitations period.

FIRST CAUSE OF ACTION

(Unlawful Business Practices In Violation Of California Business And Professions Code § 17200, et seq.)

24. Plaintiff incorporates by reference ¶¶ 1-23 of the Complaint.

25. California Business and Professions Code § 17200 provides that unfair competition shall mean and include all "unlawful . . . practice." The defendant has violated § 17200 in that it has and continues to advertise, promote, impose and collect unconscionable and illegal late charges on the credit cards it has issued to California consumers, as explained more fully above.

26. By committing the acts alleged herein, the defendant has engaged in an unlawful business practice within the meaning of California Business and Professions Code § 17200.

27. In addition, defendant's use of various forms of advertising, including the print and broadcast media, to advertise, call attention to or give publicity to the sale of

services in a deceptive manner by not disclosing the illegality and unconscionability of the late charges in question constitutes unfair competition, and unfair, deceptive, untrue or misleading advertising, and thus an unlawful business practice within the meaning of California Business and Professions Code § 17200. Defendant's advertisements have deceived and/or are likely to deceive the consuming public, in violation of, *inter alia* California Business and Professions Codes §§ 17200 and 17500.

28. Plaintiff is informed and believes that the unlawful, unfair and fraudulent business practices of the defendant, as described above, present a continuing threat to members of the public in that the defendant still systematically perpetrates a fraud upon members of the public by imposing illegal and unconscionable late charges while not disclosing that such charges are illegal and unconscionable, bilking California consumers of millions of dollars in the process.

29. Pursuant to California Business and Professions Code §§ 17203 and 17535, plaintiff seeks an order of this court enjoining the defendant from continuing to engage in, use, or employ its practice of contracting for, charging and collecting unconscionable and illegal late charges or to prohibit the defendant from refusing to disclose such misrepresentations or provide a clear and reasonable warning of the illegality and unconscionability of the late charges; and additionally requests an order awarding plaintiff and the members of the class restitution of the money wrongfully acquired by the defendant by means of such false advertising and misrepresentations, plus treble damages, interest, and attorneys fees and costs

pursuant to, *inter alia*, C.C.P. § 1021.5, so as to restore any and all money to plaintiff and the members of the class which was fraudulently acquired and obtained by means of such unfair competition and which funds are still retained by the defendant. Plaintiff and the class additionally request that such funds be impounded by the court or that a constructive trust be imposed on such monies to avoid dissipation and/or fraudulent transfers of such monies by the defendant. Plaintiff and the class may be irreparably harmed and/or denied an effective and complete remedy if such an order is not granted.

30. The defendant has caused irreparable harm for which there is no plain, speedy or adequate remedy at law.

SECOND CAUSE OF ACTION

(Breach Of Duty Of Good Faith And Fair Dealing)

31. Plaintiff incorporates by reference ¶¶ 1-30 of the Complaint.

32. The defendant owes to all California consumers who have obtained credit cards from them an implied duty to deal with such persons fairly and in good faith.

33. Plaintiff is informed and believes that throughout the class period, defendant has established and maintained a uniform policy for charging illegal and unconscionable late charges which, in intent and in practice, is arbitrary, capricious, and oppressive since such charges bear absolutely no relationship to the costs actually incurred by defendant. Said policy and the facts and practices conducted by the defendant pursuant thereto

violate the duty the defendant owes to its customers to deal with them fairly and in good faith in that such charges are set without regard for: (1) the amount of additional interest incurred on the account while the payment is outstanding; (2) the amount and type of labor involved in collecting delinquent accounts; (3) the actual cost to the defendant of not timely receiving payments; and (4) the minimum payment due upon which the defendant imposes a late charge. Customers of the defendant have no ability to affect the amount or method of calculation of said charges, because of the defendant's superior bargaining position and its take-it-or-leave-it policy. A significant purpose of the defendant's policies and practices regarding the setting of late charges is to unconscionably increase defendant's income and profit at the expense of California consumers.

34. As a result of the foregoing, plaintiff and the class are entitled to compensatory damages, plus interest, attorneys' fees and costs.

THIRD CAUSE OF ACTION

(Violation of Civil Code § 1671)

35. Plaintiff hereby incorporates by reference ¶¶ 1-34 of the Complaint.

36. As a result of having no reasonable basis for the amount of the late charges it imposes upon plaintiff and the class, and because these late charges bear no reasonable relationship to the actual damages suffered by the defendant as a result of a late payment, defendant has violated California Civil Code § 1671.

37. As a result of the foregoing, plaintiff and the class are entitled to the amount of all late charges they have paid which were collected by the defendant, less any actual damages resulting from the alleged default which triggered the late charges in question. Plaintiff is also entitled to an award of interest, attorneys' fees and costs pursuant to, *inter alia*. California Civil Code § 1021.5.

FOURTH CAUSE OF ACTION

(Unjust Enrichment And Imposition Of Constructive Trust)

38. Plaintiff hereby incorporates by reference ¶¶ 1-37 of the Complaint.

39. As a result of the tortious conduct described above, the defendant has been and will be unjustly enriched at the expense of the members of the class. specifically, the defendant has been unjustly enriched by the receipt of hundreds of millions of dollars in revenues and profits from the imposition of illegal and unconscionable credit card late charges, which are promoted and sold through advertisements which misrepresent that because of reasons other than its actual cost, such charges are necessary to recoup costs necessary in collecting late payments. In addition for the reasons detailed above, these late charges are illegal and unconscionable.

40. Unless enjoined, plaintiff and the members of the class will be irreparably harmed, having been charged late charges with no reasonable basis therefor, and plaintiff believes the defendant may transfer and/or dissipate

the proceeds from such transactions beyond the jurisdiction of this court. The defendant should therefore be required to disgorge the profits it has obtained and will unjustly obtain at the expense of the members of the class as detailed above, and a constructive trust should be imposed on all revenues thus far obtained by the defendant as a result of its collection of illegal and unconscionable late charges in order to *inter alia*, prevent the dissemination of such funds.

FIFTH CAUSE OF ACTION

(Fraud And Deceit)

41. Plaintiff hereby incorporates by reference ¶¶ 1-40 of the Complaint.

42. Defendant's representations made through its long-term advertising, promotional and marketing campaign as particularized above were misleading or were likely to mislead because they misrepresent and do not disclose that the impermissibly high late charges imposed by the defendant were illegal and unconscionable.

43. Defendant's representations and omissions regarding the necessity of and basis for imposing late charges were made with knowledge or reckless disregard of the laws of this state prohibiting false and misleading advertisements, as well as the reasonable expectations of public consumers. Such representations were made with the intent to defraud and induce plaintiff's and all class members' reliance as evidenced by the request for and actual payment of such late charges.

44. Plaintiff and the class members, unaware of the falsity of defendant's fraudulent representations of said material facts paid the illegal and unconscionable late charges, reasonably relying upon the representations of the defendant.

45. As a proximate result of the defendant's active misrepresentations or concealments of material facts regarding the illegality and unconscionability of the late charges, plaintiff and the class have suffered damages through payment of said late charges. The total amount of damages suffered by plaintiff and members of the class as a result of its payments cannot be fully ascertained without access to defendant's records and will be proven at the time of trial.

46. Defendant's suppression and/or misrepresentation of the material facts set forth above defrauded plaintiff and the class, in violation of California Civil Code §§ 1572, 1709 and 1710, as well as principles of common law, for which plaintiff and members of the class are entitled to recover compensatory damages, interest, and attorneys' fees and costs.

47. Defendant's conduct described herein was done with conscious disregard of plaintiff's rights and with the intent to vex, injure or annoy plaintiff and members of the class such as to constitute oppression, fraud or malice under California Civil Code § 3294, entitling plaintiff and the members of the class to an award of punitive damages, in an amount appropriate to punish or set an example of defendant.

SIXTH CAUSE OF ACTION

(Negligent Misrepresentation)

48. Plaintiff incorporates by reference ¶¶ 1-47 of the Complaint.

49. In making the representations of fact to plaintiff and the members of the class described herein, the defendant failed to fulfill its duty to disclose the material facts set forth above. Among the direct and proximate causes of said failure to disclose was the negligence and carelessness of the defendant.

50. Plaintiff, unaware of defendant's affirmative misrepresentations and its failure to disclose the fact that the late charges it was imposing were unconscionable and illegal, paid the improper late charges. Had plaintiff known the true facts, she would not have taken such action. By reason thereof, plaintiff and the other class members have suffered damages in an amount according to proof at the time of trial, plus interest, attorneys' fees and costs.

SEVENTH CAUSE OF ACTION

(Breach Of Contract And Rescission)

51. Plaintiff incorporates by reference ¶¶ 1-50 of the Complaint.

52. Plaintiff and the members of the class, by obtaining credit cards issued by the defendant, entered into a written contract through which the defendant benefitted by receiving millions of dollars in revenues and

profits. As part of the agreement, the defendant represented and agreed that any late charges imposed were charged in accordance with all applicable laws.

53. Plaintiff and the class were fraudulently induced by the defendant to enter into such agreements by affirmative misrepresentations which defendant knew were not true or recklessly or negligently disregarded as being not true. The defendant breached said contract by charging consumers an illegal and unconscionable late charge. The defendant made and/or conspired to or allowed to be made these misrepresentations with the intent to deceive plaintiff and members of the class into making such agreements to utilize said credit cards and/or pay such late charges. Plaintiff and the members of the class justifiably relied upon such representations in using said cards. Had plaintiff and the members of the class known of the true facts, they would not have used said cards, or would not have paid the late charges imposed by the defendant.

54. Plaintiff and the members of the class are therefore entitled to compensatory damages and/or rescission of the agreement and repayment of the late charges expended in consideration therefor, plus interest from the date of such payment, plus reasonable attorneys' fees and costs.

PRAYER FOR RELIEF

WHEREFORE, plaintiff, on behalf of herself and on behalf of the members of the class, prays for judgment

and relief on all Causes of Action against the defendant, as follows:

1. For an order certifying that the action may be maintained as a class action;

2. For compensatory and statutory damages in an amount to be proven at trial, including any damages provided for by statute, and interest thereon;

3. For punitive and/or treble damages;

4. For an order enjoining the defendant from pursuing the policies, acts, and practices complained of herein, requiring that the defendant provide public notice, a court-approved public information campaign, a clear and reasonable warning of the illegality and unconscionability of the late charges imposed and/or a refund of such late charges, and imposing a constructive trust upon defendant's ill-gotten gains and/or requiring defendant to make restitution to plaintiff and all members of the class and restore all funds acquired by means of any act or practice declared by this court to be unlawful or fraudulent, a violation of California or federal statutes or regulations or to constitute unfair competition or untrue, misleading or false advertising or violation of the Consumers Legal Remedies Act, and to disgorge all revenues and profits obtained thereby;

5. For reasonable attorneys' fees pursuant to, *inter alia*, C.C.P. § 1021.5;

6. For costs of this suit;

7. For interest on damages awarded to the class; and

8. For such other and further relief as the court deems just and proper.

Date: July 7, 1992

GREENFIELD & CHIMICLES

By: /s/ Patrick J. Grannan
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SUPREME COURT OF NEW JERSEY
A-103 September Term 1994

JAMES H. HUNTER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

Argued February 15, 1995 – Decided November 28, 1995

On certification to the Superior Court, Appellate Division, whose opinion is reported at 272 *N.J. Super.* 526 (1994).

Michael D. Donovan, a member of the Pennsylvania bar, argued the cause for appellant (*Spector Gadon & Rosen*, attorneys; *Mr. Donovan and Ann Miller*, a member of the Pennsylvania bar, of counsel; *Mr. Donovan, Ms. Miller, Paul R. Rosen* and *Robert L. Grundlock, Jr.*, on the briefs).

Arthur R. Miller, a member of the Massachusetts bar, argued the cause for respondent (*Archer & Greiner*, attorneys; *Mr. Miller* and *Sean T. O'Meara*, on the briefs)

Marilyn A. Bair, Deputy Attorney General, argued the cause for *amicus curiae* Attorney General of New Jersey (*James J. Ciancia*, Acting Attorney General, attorney; *Andrea M. Silkowitz*, Assistant Attorney General, of counsel).

Richard P. Jacobson submitted a brief on behalf of *amici curiae* The States of Arizona, Delaware,

Louisiana, Nevada, Ohio, South Dakota, and Utah (*Dunn, Pashman, Sponzilli, Swick & Finnerty,* attorneys).

Charles N. Riley submitted a brief on behalf of *amicus curiae* Consumer Action (*Tomar, Simonoff, Adourian & O'Brien,* attorneys).

Beverly R. Porway, Counsel, submitted a brief on behalf of *amicus curiae* Federal Deposit Insurance Corporation.

Charles N. Riley submitted a brief on behalf of *amici curiae* the States of Hawaii, Iowa, Maryland, Massachusetts, Pennsylvania, South Carolina, Vermont, West Virginia, and Wisconsin (*Tomar, Simonoff, Adourian & O'Brien,* attorneys).

Dennis R. Casale submitted a brief on behalf of *amici curiae* The New Jersey Bankers Association, American Bankers Association, American Financial Services Association and Consumer Bankers Association (*Jamieson, Moore, Peskin & Spicer,* attorneys).

Michael J. Dunne submitted a brief on behalf of *amici curiae* Visa U.S.A., Inc., and Mastercard International Incorporated (*Pitney, Hardin, Kipp & Szuch,* attorneys).

The opinion of the Court was delivered by HANDLER, J.

The facts and issues in this case are substantially similar to those in the companion case, *Sherman v. Citibank (South Dakota), N.A.,* ___ N.J. ___, *rev'g* 272 *N.J. Super.* 526 (1994), also decided today. Here, New Jersey credit-card holders challenge the legality of late-payment fees assessed by Greenwood Trust, a federally-insured state bank chartered in Delaware. The bank, on the other

hand, claims that it is permitted under the Depository Institutions Deregulation and Monetary Control Act to charge out-of-state customers the same interest rate and other lender-imposed charges it is authorized to charge its own customers.

The specific issues are framed by the contentions of the parties. Plaintiff is the named party in this class-action suit. As in *Sherman,* plaintiff argues that New Jersey's Retail Installment Sales Act, *N.J.S.A.* 17:16C-50, -54 (RISA) (since amended, *L.* 1995, *c.* 43) forbids federally-insured state banks that issue credit cards to New Jersey customers from charging late-payment fees, that defendant's advertising and cardmember agreements violate New Jersey's Consumer Fraud Act, *N.J.S.A.* 56:8-2, -19 (CFA), and that the imposition of late-payment fees constitutes a common-law breach of contract and conversion. Like the claims in *Sherman,* plaintiff's claims focus on whether the notion of interest includes late-payment charges.

Greenwood Trust, however, argues it is free to charge late-payment fees in New Jersey. It relies on section 521 of the Depository Institutions Deregulation and Monetary Control Act, 12 *U.S.C.A.* § 1831d (DIDA), which expressly mirrors section 85 of the National Bank Act, 12 *U.S.C.A.* § 85 (NBA), and provides that federally-insured state banks may charge borrowers "interest at a rate allowed by the laws of the State . . . where the bank is located." 12 *U.S.C.A.* § 1831d(a). Section 521 expressly preempts conflicting state "constitution[s] or statute[s]." *Ibid.* Because it is a federally-insured state bank chartered in Delaware, which includes late fees in its statutory definition of

interest, Greenwood Trust argues that RISA and plaintiff's other claims conflict with, and are preempted by, section 521. 272 *N.J. Super.* at 529-30.

The Law Division dismissed the complaint. The Appellate Division affirmed, 272 *N.J. Super.* 526, and we granted plaintiff's petition for certification. 138 *N.J.* 270 (1994).

For substantially the same reasons expressed in *Sherman*, we conclude that this State's usury law prohibiting banks from charging late fees does not conflict with the federal statute giving national banks and federally-insured state banks preferential treatment with respect to lending authority. We hold that DIDA does not preempt the New Jersey RISA's prohibition on late-payment fees, and, therefore, reverse the judgment of the Appellate Division.

I

Although it is clear that Congress intended section 521 to preempt conflicting state usury provisions, federal preemption of state law requires an actual conflict, not merely a potential, speculative or hypothetical one. *Rice v. Norman Williams Co.*, 458 *U.S.* 654, 659, 102 *S. Ct.* 3294, 3298-99, 73 *L. Ed.* 2d 1042, 1049 (1982); *Brown v. Hotel Employees International Union*, 468 *U.S.* 491, 510, 104 *S. Ct.* 3179, 3185, 82 *L. Ed.* 2d 373, 389 (1963). An actual conflict arises when it is impossible to comply with both state and federal law, or when state law is an obstacle to the accomplishment of the full purposes and objectives of Congress. *Schneidewind v. ANR Pipeline Co.*, 485 *U.S.* 293, 299-300, 108 *S. Ct.* 1145, 1150-51, 99 *L. Ed.* 2d 316, 325

(1988); *Feldman v. Lederle Lab.*, 117 *N.J.* 125, 135 (1991). However, courts faced with potentially conflicting state and federal statutes must attempt to harmonize them whenever possible. *Exxon Corp. v. Hunt*, 97 *N.J.* 526, 533 (1984) (citing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 *U.S.* 132, 83 *S. Ct.* 1210, 10 *L. Ed.* 2d 248 (1963); *Huron Cement Co. v. City of Detroit*, 362 *U.S.* 440, 80 *S. Ct.* 813, 4 *L. Ed.* 2d 852 (1960)). "Preemption of state law by federal statute is not favored 'in the absence of persuasive reasons – either that the nature of the regulated subject matter permits no other conclusion, or that Congress has unmistakenly so ordained.' " *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 *U.S.* 311, 317, 101 *S. Ct.* 1124, 1130, 67 *L. Ed.* 2d 258, 264-65 (1981) (quoting *Florida Lime & Avocado Growers' Inc.*, *supra*, 373 *U.S.* at 142, 83 *S. Ct.* at 1217, 10 *L. Ed.* 2d at 257).

Section 521 of DIDA provides that any federally-insured state bank may:

> notwithstanding any State constitution or statute to the contrary which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill or exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State . . . where the bank is located, whichever may be the greater. . . .
>
> [12 *U.S.C.A.* § 1831d(a).]

The language and purpose of section 521 essentially imitate that of section 85 of the NBA. *See, e.g., Copeland v. MBNA America Bank, N.A., Colo.* (1995) (slip op. at 14). Courts and federal agencies have interpreted Section 521 as conferring on federally-insured state banks the same insulation from State usury laws that national banks have enjoyed for over 100 years under the NBA. *Greenwood Trust Co. v. Massachusetts*, 971 *F.*2d 818, 826-27 (1st Cir. 1992) (concluding that section 521 permits federally-insured state banks to "export" interest rates), *rev'g* 776 *F. Supp.* 21 (D. Mass. 1991); *Vanderweyst v. First State Bank*, 425 *N.W.*2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most-favored-lender" status), *cert. denied*, 408 *U.S.* 943, 109 *S. Ct.* 369, 102 *L. Ed.* 2d 359 (1988); *Smiley v. Citibank (South Dakota). N.A.*, 44 *Cal. Rptr.* 2d 441, 465, 66 (1995) (Arabian, J., dissenting); *id.* at 467-68 (George, J., dissenting). Thus, "interest," as that term is used in the NBA and DIDA, should be construed uniformly. *E.g., Greenwood Trust, supra*, 971 *F.*2d at 827 ("historical record clearly requires a court to read the parallel provisions of DIDA and the Bank Act in *pari materia*"); *see also Morales v. Trans World Airlines, Inc.*, 504 *U.S.* 374, 384, 112 *S. Ct.* 2031, 2037, 119 *L. Ed.* 2d 157, 167 (1992) (finding that when legislature borrows exact phrase from existing statute, courts should adopt prior judicial interpretations of that phrase). As demonstrated in *Sherman*, the term "interest" in the NBA does not include late fees, ___ *N.J.* ___at (slip op. at 5-26); *Smiley, supra*, 44 *Cal. Rptr*, 2d at 469 (George, J., dissenting). We conclude that "interest" in DIDA similarly does not include late fees.

Like section 85, the language in section 521 expressly refers to interest rates. It says nothing about other specific charges associated with lending money. Thus, it would be improvident to impute to Congress the intent to include in the statute a meaning it did not express. Moreover, as we discussed at length in *Sherman*, the legislative history surrounding DIDA's enactment indicates that Congress intended to preempt only state usury laws regarding traditional interest, namely, periodic percentage rates, not other specific charges. *See Sherman*, ___ *N.J.* at ___ (slip op. at 10-14); *see also Smiley, supra*, 44 *Cal. Rptr.* 2d 441, 465 (Arabian, J., dissenting).

The record of Congressional debate and deliberation concerning the enactment of DIDA is generally supportive of the notion that preemption of credit-card regulation under DIDA is confined to numerical interest rates. *Ibid.* Even if the sponsors and supporters of DIDA preemption provisions were shown to be committed to achieving total competitive equality of all lending terms offered by state banks and national banks, the simultaneous and persistent concerns of the bill's sponsors to preserve state consumer protection must likewise be acknowledged. During Senate consideration of the conference report on March 27, 1980, Senator Proxmire emphasized the limited preemptive scope of Title V.[1] This

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[1] 126 Cong. Rec. S. 6900 (March 27, 1980):

> I wish to reemphasize the point made initially in the Senate Banking Committee report that in exempting mortgage loans from State usury limitations, we intend to exempt only those limitations that are included in the annual percentage rate. We do not intend to exempt limitations on prepayment charges,

limitation, in DIDA's Title V, to annual percentage rates is clear from the Senate floor discussions of mortgage loans, from the Senate Banking Committee Report, and from the hearings on DIDA in the House of Representatives.[2]

II

In this case, as in *Sherman*, the defendant relies on an agency interpretation of the statute to support its expanded notion of interest. However, to rely upon agency determinations in this case would be to undermine our responsibility to interpret the law by the views of an entity that has heretofore failed to provide a clear and consistent understanding of what Congress intended to include in its definition of interest. Far less than the usual amount of deference to an agency interpretation is

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attorneys' fees, late charges or similar limitations designed to protect borrowers.

[2] An official of the Federal National Mortgage Association, in response to an inquiry by Rep. St. Germaine, Chair of a House subcommittee considering DIDA, referred to the Senate Banking Committee Report cites above and stated:

> This expression of legislative intent not to displace state laws designed for consumer protection with regard to charges other than charges treated as interest would leave in place those protective enactments in the various states that relate to prepayment penalties, *late charges*, regulations on disclosure of interest charges and restrictions on other costs in connection with loan transactions *other than interest*.
>
> [*Regulation Q. and Related Measures: Hearings Before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs*, 96th Cong., 2d Sess. 125-26 (1980) (emphasis added).]

appropriate when that agency has failed to adopt a consistent interpretation in administering the statute in question. *See Sherman, supra,* ___ *N.J.* ___ at (slip op. at 21-23) (citing *INS v. Cardoza-Fonseca,* 480 *U.S.* 421, 446 n.30, 107 *S. Ct.* 1207, 1221 n.30, 94 *L. Ed.* 2d 434, 457 n.30 (1987); *Watt v. Alaska,* 451 *U.S.* 259, 273, 101 *S. Ct.* 1673, 1681, 68 *L. Ed.* 2d 80 (1981); *General Elec. Co. v. Gilbert,* 429 *U.S.* 125, 143, 97 *S. Ct.* 401, 411-12, 50 *L. Ed.* 2d 343 (1976)); *see also Director, Office of Workers' Compensation Programs v. Mangivest,* 826 F.2d 1318, 1319-20 (3d Cir. 1987) (finding "ambiguities and inconsistencies in the Director's interpretation . . . of regulations . . . sufficiently great to preclude deference"); *Disabled in Action v. Sykes,* 833 F.2d 1113, 1117-19 (3d Cir. 1987), *cert. denied,* 485 *U.S.* 989, 108 *S. Ct.* 1293, 99 *L. Ed.* 2d 503 (1988); *Revak v. National Mines Corp.* 808 F.2d 996, 1002 (3d Cir. 1986) (rejecting deference arguments due to inconsistent agency interpretation of statute). Neither the Office of the Comptroller of the Currency (OCC), which regulates national banks, nor the Federal Depository Insurance Company (FDIC), the agency charged with the regulation of federally-insured banks, has issued consistent rulings concerning the interpretation of interest for purposes of the NBA and DIDA. *See Sherman, supra,* ___ *N.J.* at ___(slip. op. at 23-26). *But cf. Copeland, supra,* ___ *Colo.* at ___ (slip op. at 13) (asserting that "[t]he OCC *consistently* has taken the position that late payment fees are interest" under both section 85 of the NBA and section 521 of the DIDA) (emphasis added). Inconsistent agency rulings should not be guides for a judiciary, the government branch principally responsible for the construction of statutes. *See, e.g., SEC v. Sloan,* 436 *U.S.* 103, 118, 98 *S. Ct.* 1702, 1711, 56 *L. Ed.* 2d

148 (1978); *Federal Maritime Comm. v. Seatrain Lines, Inc.*, 411 *U.S.* 726, 745-46, 93 *S. Ct.* 1773, 1784-85, 36 *L. Ed.* 2d 620, 633-34 (1973).

III

In addition, New Jersey's State Bank Parity Act, *N.J.S.A.* 17:13B-1 to -2, does not authorize banks located in this State to charge late-payment fees in the guise of interest. *Sherman*, ___ *N.J.* at ___ (slip. op. at 28-31). Defendant contends, as did the defendant in *Sherman*, that because New Jersey credit unions are authorized to charge late fees to credit-card customers, *N.J.S.A.* 17:13-104b, New Jersey banks are so authorized pursuant to the State Bank Parity Act. That is simply not the case.

The State Bank Parity Act authorizes New Jersey banks to charge the same "rate of interest" charged by credit unions. *N.J.S.A.* 17:13B-2 provides, in pertinent part, that,

> any bank, savings bank, savings and loan association or credit union may charge a rate of interest on any class or type of loan at the rate of interest permitted to any other lender by the laws of this State on that class or type of loan.
>
> [*N.J.S.A.* 17:13B-2 (emphasis added).]

Although the Act provides for parity between the rates of interest charged by both banks and credit unions, the act does not explicitly authorize banks to charge other types of fees. Furthermore, there is no indication that the Legislature implicitly intended to authorize the imposition of such other fees in the State Bank Parity Act. *See Sherman, supra*, ___ *N.J.* at ___ (slip op. at 28-32). There are

sound reasons grounded in public policy why the Legislature would choose not to equate interest charges with other imposed fees like late charges. For example, because small, individualized lenders, such as credit unions, serve their own members and do not cater to a large market, they cannot spread costs like banks. Thus, they must be permitted to take certain actions to insure their solvency, such as charging late-payment fees. *Ibid.*

We hold that Greenwood Trust has failed to demonstrate a Congressional intention to preempt state usury laws that prohibit discrete, specialized charges that do not directly affect the interest rate. Thus, there is no conflict between New Jersey's RISA statute and DIDA. Prohibiting either national banks or federally-insured state banks from charging late fees does not constitute discrimination because, at the time defendant procured those charges, New Jersey banks were likewise prohibited from assessing them. Unless Congress itself expressly provides otherwise through legislation, we find that New Jersey's RISA statute prohibits Greenwood Trust from charging New Jersey customers late fees.

We note, however, as we did in *Sherman, supra*, ___ *N.J.* at ___ (slip op. at 39), that the late-charges at issue in this case were assessed prior to the enactment of *L.* 1995, *c.* 43, which amended the RISA to specifically allow for late-payment charges on retail charge accounts. The new statute, which took effect on May 29, 1995, applies prospectively only, and therefore is inapplicable to the late-payment charges at issue here. Nevertheless, we recognize that the newly amended RISA statute authorizes holders of retail charge accounts to charge late fees to customers. Thus, it would appear that *N.J.S.A.* 17:16C-42,

as amended, permits national banks and federally-insured state banks issuing credit cards to charge late-payment fees. *Sherman, supra,* ___ *N.J.* at ___ (slip op. at 39-42). The charges at issue in this case, however, are not permissible because they were assessed prior to May 29, 1995, the date the amendment became effective.

IV

The judgment of the Appellate Division is reversed.

Chief Justice Wilentz and Justices Stein, and Coleman join in Justices Handler's opinion. Justice Pollock has filed a separate dissenting opinion in which Justice Garibaldi joins. Justice O'Hern has also filed a separate dissenting opinion.

SUPREME COURT OF NEW JERSEY
A-103 September Term 1994

JAMES H. HUNTER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

POLLOCK, J., dissenting.

This appeal focuses on the question whether late-payment fees are included in the definition of "interest" in the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 *U.S.C.A.* § 1831d ("DIDA"). A related issue is whether the DIDA preempts state laws prohibiting late fees. As in the companion case, *Sherman v. Citibank (South Dakota), N.A.,* ___ *N.J.* ___ (1995), also decided today, the Law Division dismissed the complaint. The Appellate Division affirmed, 272 *N.J. Super.* 526 (1994). The majority reverses. I dissent.

-I-

The facts in this case are substantially similar to those in *Sherman*. James H. Hunter is the plaintiff in a class action challenging the legality of late fees charged to New Jersey holders of credit cards issued by Greenwood Trust, a federally-insured Delaware bank. Hunter argues that New Jersey's Retail Installment Sales Act of 1960, *N.J.S.A.* 17:16C-50, to -54 ("RISA"), forbids federally-insured state banks from charging late fees to New Jersey consumers.

He also argues that Greenwood Trust's cardmember agreement violates *N.J.S.A.* 56:8-2 and -19 (which prohibit consumer fraud), and that the imposition of late fees constitutes a common-law breach of contract and conversion. Like the claims in *Sherman*, Hunter's claims depend on whether interest includes late fees.

The DIDA, like the National Bank Act (NBA). which was the subject of *Sherman*, authorizes federally-insured state banks to charge borrowers "interest . . . allowed by the laws of the State . . . where the bank is located." Delaware's statutory definition of interest includes late fees: "If the agreement governing a revolving credit plan so provides, a bank may impose, as interest, a late or delinquency charge." *Del. Code Ann.* tit. 5, § 950 (1994). Thus, Greenwood Trust maintains both that the DIDA expressly authorizes charging late fees as interest and that the DIDA preempts conflicting state laws.

Hunter, however, contends that late fees are not interest under the DIDA. Specifically, he asserts that "interest" refers only to the periodic percentage rate charged on outstanding balances. He argues that his state-law claims do not conflict with the DIDA, and therefore that the DIDA does not preempt them. Alternatively, Hunter argues that the DIDA's express preemption clause preempts only his statutory, but not his common-law, claims.

-II-

This case requires us to determine the meaning of "interest . . . allowed by the laws of the State . . . where the bank is located," as that phrase is used in the DIDA.

Ultimately, matters of statutory construction involve a determination of congressional intent. *E.g., Norfolk and Western Ry. Co. v. American Train Dispatchers Ass'n*, 499 U.S. 117, 128, 111 *S. Ct.* 1156, 1163, 113 *L. Ed.* 2d 95, 106-07 (1991); *Roig v. Kelsey*, 135 *N.J.* 500, 515 (1994). In the DIDA, Congress did not expressly define "interest." Nor does a fair reading of the legislative history disclose the intended meaning of that term.

As discussed more fully in my dissent in *Sherman, supra*, ___ *N.J.* at ___ (slip op. at 6), the Civil War Congress enacted section 85 of the NBA to protect the newly-created national banking system from unfriendly state usury laws. Section 85 provides that any national bank

> may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at a rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater. . . .
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> [12 *U.S.C.A.* § 85.]

In *Tiffany v. National Bank of Missouri*, 85 *U.S.* (18 Wall.) 409, 411-13, 21 *L. Ed.* 862, 863-64 (1873), the United States Supreme Court held, pursuant to section 85, that the defendant national bank could charge its borrowers the highest interest rate authorized to any lender in that state. The Court acknowledged that the "most favored lender" doctrine might disadvantage state-chartered banks, but relied on Congress's intent to create a strong

national banking system immune from hostile state legislation. *Id.* at 412-13, 21 *L. Ed.* at 863-64.

A century later, the Court determined that a national bank located in one state could charge its borrowers in other states the highest interest rate allowed to any lender in its home state. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 *U.S.* 299, 99 *S. Ct.* 540, 58 *L. Ed.* 2d 534 (1978).

In the years following *Marquette*, interest rates soared. Although national banks could charge interest at a rate tied to the federal discount rate, local usury laws constrained state banks. *See Greenwood Trust Co. v. Massachusetts*, 971 *F.* 2d 818, 826 (1st Cir. 1992), *cert. denied*, ___ *U.S.* ___, 113 *S. Ct.* 974, 122 *L. Ed.* 2d 129 (1993). Congress rectified the imbalance by enacting the DIDA. *Ibid.*

Section 521 of the DIDA ("section 521") provides that

> [i]n order to prevent discrimination against any [federally-insured state bank], such State bank may . . . notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State

> . . . where the bank is located, whichever may be the greater. . . .
>
> [12 *U.S.C.A.* § 1831d(a).]

The text of section 521 virtually mirrors that of section 85. Section 521 articulates Congress's intent that the purpose of the DIDA, like that of the NBA, is to prevent discrimination against federally-insured state banks. Unsurprisingly, courts and banking regulators have interpreted section 521 as protecting federally-insured state banks from hostile state laws, just as section 85 protects national banks from those laws. *Greenwood Trust, supra*, 971 *F.* 2d at 826-27 (concluding that section 521 permits federally-insured state banks to "export" interest rates); *VanderWeyst v. First State Bank*, 425 *N.W.*2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most favored lender" status), *cert. denied*, 488 *U.S.* 943, 109 *S. Ct.* 369, 102 *L. Ed.* 2d 359 (1988); Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep.* (CCH) ¶ 81,534 at 55,730 (July 8, 1992) (most favored lender and exportation principle); Letter by Frank L. Skillern, Jr., General Counsel, FDIC No. 81-3 (February 8, 1981) (most favored lender status); Letter by Kathy A. Johnson, Attorney, FDIC No. 81-7 (March 17, 1981) (exportation principle).

I agree with the majority, *ante* at ___ (slip op. at 6), that "interest," as that term is used in the NBA and the DIDA, should be construed uniformly. *E.g.*, *Greenwood Trust, supra*, 971 *F.* 2d at 827; *see also Morales v. Trans World Airlines, Inc.*, 504 *U.S.* 374, 383-84, 112 *S. Ct.* 2031, 2037, 119 *L. Ed.* 2d 157, 167 (1992) (finding that when legislature borrows exact phrase from existing statute, courts

should adopt prior judicial interpretations of that phrase). Substantially for the reasons set forth in my *Sherman* opinion, ___ *N.J.* ___, I conclude that "interest" in the DIDA includes late fees.

Interpretations of the Federal Depository Insurance Company (FDIC), the agency charged with the regulation of federally-insured banks, 12 *U.S.C.A.* § 1811, support that conclusion. In my dissent in *Sherman, supra,* ___ *N.J.* at ___ (slip op. at 1314), I noted that when Congress does not define a statutory term, courts should accept a reasonable interpretation of the term of the appropriate administrative agency. *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 *U.S.* ___, ___, 115 *S. Ct.* 810, 813, 130 *L. Ed.* 2d 740, 747 (1995); *Chevron, U.S.A., Inc. v. NRDC*, 467 *U.S.* 837, 843-44, 104 *S. Ct.* 2778, 2782-83, 81 *L. Ed.* 2d 694, 703-04 (1984); *Lammers v. Board of Educ.*, 134 *N.J.* 264, 274 (1993); *Metromedia, Inc. v. Director, Div. of Taxation*, 97 *N.J.* 313, 327 (1984); Kenneth C. Davis & Richard J. Pierce, Jr., *Administrative Law Treatise*, § 3.3 (3d ed. 1994) (discussing *Chevron*); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 *Duke L.J.* 511, 516-18 (1989) (same). As described in my dissent in *Sherman, supra,* ___ *N.J.* at ___ (slip op. at 16-18), the Comptroller of the Currency, which regulates national banks, has long ruled that interest could include late fees. Like the Comptroller, the FDIC has concluded that interest, for purposes of section 521, includes late fees that are authorized by a bank's home state. Letter from Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep.* (CCH) ¶ 81,534 at 55,730 (July 8, 1992). As in *Sherman*, I find that interpretation reasonable.

-III-

Whether a federal law, such as the DIDA, preempts a state law is a matter of congressional intent. *E.g., Cipollone v. Liggett Group, Inc.*, 505 *U.S.* 504, ___, 112 S. Ct. 2608, 2617-18, 120 *L. Ed.* 2d 407, 422-23 (1992). The inclusion of an express preemption clause unmistakably declares the intent of Congress to preempt conflicting state statutes. *Ibid.*

The DIDA, unlike the NBA, includes such an express preemption clause. Section 521 permits a national bank to charge interest at a rate allowed by its home state "notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section. . . . " The word "notwithstanding" suggests that Congress intended the DIDA to preempt conflicting state statutes. Thus, under the language of the DIDA's express preemption clause, the question is whether RISA's prohibition against late fees conflicts with section 521.

In *Sherman, supra,* ___ *N.J.* at ___ (slip op. at 28), I concluded that section 85 conflicts with state laws, such as RISA, that prohibit late fees. I likewise submit that section 521 conflicts with state laws prohibiting such fees. Under its express preemption clause, the DIDA perempts Hunter's statutory claims.

I further determined in *Sherman* that New Jersey's State Bank Parity Act authorizes banks located in this State to charge interest in the form of late-payment fees. ___ *N.J.* at ___ (slip op. at 27-28); *see* Letter by Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994). Because I conclude that New Jersey banks may charge late fees to their New Jersey customers, I also

conclude that a state law prohibiting out-of-state federally-insured state banks from charging such fees impermissibly discriminates against those institutions. *See Sherman, supra,* ___ *N.J.* at ___ (slip op. at 28). That conflict with the congressional intent to prevent discrimination against federally-insured state banks further supports my conclusion that the DIDA preempts state statutes that prohibit late fees.

-IV-

Hunter argues alternatively that even if the DIDA preempts his statutory claims, his common-law claims must survive. Specifically, he argues that the United States Supreme Court's holding in *Cipollone, supra,* 505 *U.S.* 504, 112 *S. Ct.* 2608, 120 *L. Ed.* 2d 407, limits the DIDA's preemptive scope to "State constitution[s] or statute[s]." 12 *U.S.C.A.* § 1831d(a). I disagree.

The Court recently addressed a comparable issue in *Freightliner Corp. v. Myrick,* 514 *U.S.* ___, 115 *S. Ct.* 1483, 131 *L. Ed.* 2d 385 (1995). In *Freightliner,* the Court clarified that *Cipollone* does not preclude implied preemption whenever Congress includes an express preemption clause in a federal statute. 514 *U.S.* at ___, 115 *S. Ct.* at 1487-88, 131 *L. Ed.* 2d at 393. "At best, *Cipollone* supports an inference that an express pre-emption clause forecloses implied pre-emption; it does not establish a rule." *Id.* at ___, 115 *S. Ct.* at 1488, 131 *L. Ed.* 2d at 393. The Court emphasized that a statute's preemptive scope is a function of congressional intent. *Id.* at ___, 115 *S. Ct.* at 1487, 131 *L. Ed.* 2d at 393.

I believe that Congress intended that section 521 of the DIDA should have the same preemptive effect as section 85 of the NBA. A recent interpretive letter by the FDIC further supports that conclusion. Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 93-27, *Fed. Banking L. Rep.* (CCH) ¶ 81,635 at 55,838 (July 12, 1993) (concluding that Congress intended to confer upon federally-insured banks the same protections that section 85 of the NBA confers on national banks). I conclude that Hunter's common-law claims, like his statutory claims, conflict with the DIDA and are preempted.

-V-

In *Sherman, supra,* ___ *N.J.* at ___ (slip op. at 28-29), I disagreed with the majority's conclusion that in the future, out-of-state federally-insured state banks may charge late fees on delinquent customers, but only up to $10. Although I agree that those banks may charge such fees, I disagree that state law may limit the amount so charged. As a national banking law, the DIDA takes precedence over conflicting state law. Under the authority of the DIDA, Greenwood Trust may impose late fees as authorized by its home state, Delaware, without reference to another state's limitation on those fees. Consequently, the RISA's limitation on late charges must yield to the DIDA, as construed by the FDIC.

Accordingly, I respectfully dissent.

Justice Garibaldi joins in this dissent.

SUPREME COURT OF NEW JERSEY
A-103 September Term 1994

JAMES H. HUNTER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

O'HERN, J., dissenting.

I dissent for the reasons stated in my separate opinion in *Sherman v. Citibank*, ___ *N.J.* ___, also filed today.

SUPREME COURT OF NEW JERSEY
A-102 September Term 1994

MARC SHERMAN, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant-Respondent.

Argued February 15, 1995 – Decided November 28, 1995

On certification to the Superior Court, Appellate Division, whose opinion is reported at 272 *N.J. Super*. 435 (1994).

Michael D. Donovan, a member of the Pennsylvania bar, argued the cause for appellant (*Spector Gadon & Rosen*, attorneys; *Mr. Donovan* and *Ann Miller*, a member of the Pennsylvania bar, of counsel; *Mr. Donovan, Ms. Miller, Paul R. Rosen*, and *Robert L. Grundlock, Jr.*, on the briefs).

Louis R. Cohen, a member of the District of Columbia bar, argued the cause for respondent (*Dechert Price & Rhoads*, attorneys; *Mr. Cohen, George G. O'Brien, Matthew V. DelDuca*, and *Robert D. Rhoad*, on the briefs).

Marilyn A. Bair, Deputy Attorney General, argued the cause for *amicus curiae* Attorney General of New Jersey (*James J. Ciancia*, Acting Attorney General, attorney; *Andrea M. Silkowitz*, Assistant Attorney General, of counsel).

Richard P. Jacobson submitted a brief on behalf of *amici curiae* The States of Arizona, Delaware, Louisiana, Nevada, Ohio, South Dakota, and Utah (*Dunn, Pashman, Sponzilli, Swick & Finnerty*, attorneys).

Irene E. Dowdy, Assistant United States Attorney, submitted a brief on behalf of *amicus curiae* Office of the Comptroller of the Currency (*Faith S. Hochberg*, United States Attorney, attorney).

Charles N. Riley submitted a brief on behalf of *amicus curiae* Consumer Action (*Tomar, Simonoff, Adourian & O'Brien*, attorneys).

Charles N. Riley submitted a brief on behalf of *amici curiae* the States of Hawaii, Iowa, Maryland, Massachusetts, Pennsylvania, South Carolina, Vermont, West Virginia, and Wisconsin (*Tomar, Simonoff, Adourian & O'Brien*, attorneys).

Mark L. First submitted a brief on behalf of *amicus curiae* Mellon Bank (DE), N.A. (*Reed, Smith, Shaw & McClay*, attorneys).

Dennis R. Casale submitted a brief on behalf of *amici curiae* The New Jersey Bankers Association, American Bankers Association, American Financial Services Association and Consumer Bankers Association (*Jamieson, Moore, Peskin & Spicer*, attorneys).

Jeffrey M. Keiser submitted a brief on behalf of *amici curiae* Trial Lawyers for Public Justice, P.C., and Bankcard Holders of America, Inc.

Michael J. Dunne submitted a brief on behalf of *amici curiae* Visa U.S.A., Inc., and Mastercard International Incorporated (*Pitney, Hardin, Kipp & Szuch*, attorneys).

The opinion of the Court was delivered by HANDLER, J.

In this case, as in the companion case of *Hunter v. Greenwood Trust Co.*, ___ *N.J.* ___, *rev'g* 272 *N.J. Super.* 526 (1994), also decided today, New Jersey credit-card customers contend that New Jersey's usury laws prohibit banks that issue those cards from charging late-payment fees to New Jersey customers.

The issues before us are more specifically framed by the claims and defenses of the respective parties. Plaintiff, as a named party in a class-action suit, challenges the legality of the late-payment fees that are charged to New Jersey holders of defendant Citibank (South Dakota) credit cards. Plaintiff argues that New Jersey's Retail Installment Sales Act of 1960, *N.J.S.A.* 17:16C-50, -54 (RISA), forbids national banks that issue credit-cards to New Jersey consumers from charging late-payment fees. Plaintiff also argues that defendant's failure to disclose in its cardmember agreements and advertising that late-payment fees are prohibited by New Jersey law violates New Jersey's Consumer Fraud Act (CFA), *N.J.S.A.* 56:8-2, -19. Finally, plaintiff contends that the imposition of late-payment fees constitutes a common-law breach of contract and conversion.

Defendant relies on section 85 of the National Bank Act (NBA), which provides that a national bank may charge borrowers "interest at a rate allowed by the laws of the State . . . where the bank is located." 12 *U.S.C.A.* § 85. Citibank is a national bank chartered in South Dakota, and South Dakota includes late-payment fees in its statutory definition of interest. 272 *N.J. Super.* at 438.

Citibank, therefore, contends that plaintiff's RISA claim, as well as plaintiff's other claims, conflict with, and are preempted by, section 85. *See id.* at 439. Thus, Citibank argues it is free to charge late-payment fees in New Jersey.

Following the commencement of this action, the Law Division granted the bank's motion to dismiss the complaint with prejudice. The Appellate Division affirmed. 272 *N.J. Super.* 435 (1994). We granted plaintiff's petition for certification, 138 *N.J.* 270 (1994), and now reverse the dismissal of plaintiff's claims.

We determine that the understanding of "interest" as expressed and authorized in the NBA does not include distinctive and contingent loan terms or charges, such as late fees, that are unrelated to interest rates. We hold that late-payment fees are not "interest" within the intendment and purposes of the applicable federal statute. Rather, "interest at a rate allowed by the laws of the State . . . where the bank is located" refers only to the periodic percentage rate charged on outstanding balances. Therefore, plaintiff's state-law defenses to the bank's charges do not conflict with federal law, are not preempted, and the late-payment fees are illegal under New Jersey law.

I

Since the early years of the Republic, the states have generally resisted the development of national banks and favored their own state-chartered banks through regulatory legislation. William Oscar Scroggs, *A Century of Banking Progress* 50-51 (1924); John J. Knox, *A History of*

Banking in the U.S. 12 (2d ed. 1969). The Supreme Court has, since *M'Culloch v. Maryland,* 17 *U.S.* (4 Wheat) 316, 4 *L. Ed.* 579 (1819), generally limited federal statutory involvement by construing preemption narrowly and giving relatively free rein to state usury law regulations. *See Anderson Nat'l Bank v. Luckett,* 321 *U.S.* 233, 64 *S. Ct.* 599, 88 *L. Ed.* 692 (1944); *McClellan v. Chipman,* 164 *U.S.* 347, 17 *S. Ct.* 85, 41 *L. Ed.* 461 (1896).

This Court, in considering preemption claims, must be cautioned by the longstanding presumption that "Congress did not intend to displace state law." *Maryland v. Louisiana,* 451 *U.S.* 725, 746, 101 *S.Ct.* 2114, 2129, 68 *L. Ed.* 2d 576, 595 (1981), and that it should not unnecessarily disturb "the federal-state balance." *United States v. Bass,* 404 *U.S.* 336, 349, 92 *S. Ct.* 515, 523, 30 *L. Ed.* 2d 488, 497 (1971). Indeed, greater restraint ought apply to preemption of spheres traditionally occupied by the states. Where the field that Congress is said to have preempted has been traditionally occupied by the states, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless there was the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.,* 331 *U.S.* 218, 230, 67 *S.Ct.* 1146, 1152, 91 *L. Ed.* 1447 (1947).

"It is well settled that state usury law restrictions on lending practices are so extensive and historically rooted as to form part of the consumer protection terrain 'traditionally occupied' by the states." *Greenwood Trust Co. v. Massachusetts,* 776 *F. Supp.* 21, 27-28 (D. Mass. 1991), *rev'd,* 971 *F.*2d 818 (1st Cir. 1992), *cert. denied,* ___ U.S. ___, 113 *S. Ct.* 974, 122 *L. Ed.* 2d 129 (1993) (citing *Lewis v. BT Inv. Managers, Inc.,* 447 *U.S.* 27, 38, 100 *S.Ct.* 2009, 2016, 64 *L.*

Ed. 2d 702, 713 (1980) ("We readily accept the submission that, both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern")); *Smiley v. Citibank (South Dakota), N.A.*, 44 *Cal. Rptr.* 2d 441, 465-66 (1995) (Arabian, J., dissenting) (same); *id.* at 467-68 (George, J., dissenting) (same). Accordingly, "[b]ecause consumer protection law is a field traditionally regulated by the states, compelling evidence of an intention to preempt is required in this area." *General Motors Corp. v. Abrams*, 897 *F.*2d 34, 41-42 (2d Cir. 1990) (upholding New York's "Lemon Law" against a claim that a Federal Trade Commission consent decree preempted major elements of the local law). Congress' failure to include an express preemption clause in section 85 necessitates a careful examination of whether the NBA conflicts with RISA's prohibition of late-payment fees.

Section 85 provides in pertinent part:

> Any [national bank] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, *interest at a rate allowed by the laws of the State, Territory or District where the bank is located*, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater . . .
>
> [12 *U.S.C.A.* § 85 (emphasis added).]

On its face, section 85 immunizes national banks that lend money beyond their home-state's borders from local

usury laws that might give local banks a competitive advantage. It also protects national banks during periods of inflation by overriding even the home-state's usury laws and permitting national banks to charge interest at a rate tied to the federal discount rate. *E.g.*, *Tiffany v. National Bank*, 85 *U.S.* (18 Wall) 409, 412-13, 21 *L. Ed.* 862, 863-64 (1874) (holding that Congress, by enacting NBA, intended to protect national banks from hostile state usury laws); *Roper v. Consurve, Inc.*, 578 *F.* 2d 1106 (5th Cir. 1978), *aff'd sub nom.*, *Deposit Guaranty Nat'l Bank v. Roper*, 445 *U.S.* 326, 100 *S. Ct.* 1166, 63 *L. Ed.* 2d 427 (1980) (holding section 85 was designed by Congress to mandate parity between national banks and local lenders). However, neither the plain meaning of the terms "rate" and "interest" in section 85, nor the legislative history of that provision indicates that these terms carry the expansive meaning inferred by defendant. *See Smiley, supra*, 44 *Cal. Rptr.* 2d at 469 (George, J., dissenting).

Since 1874, the Supreme Court has interpreted section 85 as entitling a national bank to charge the highest interest rate allowed to lenders by the laws of the state in which the bank is located. *Tiffany, supra*, 85 *U.S.* at 411-13, 21 *L. Ed.* at 863-64 ("The only mode of guarding against [state discrimination] was . . . to allow to national associations the rate allowed by the state to natural persons generally, and a higher rate"). Courts have recognized that *Tiffany* construed section 85 to place national banks in a position of limited advantage over state banks by allowing them to charge interest at the highest rate applicable under state law to lenders generally and not necessarily at a rate applicable to state banks, which might be lower. This ability to "borrow" an interest rate has come

to be known as the "most-favored-lender" doctrine. *See, e.g., Fisher v. First Nat'l Bank,* 548 F.2d 255 (8th Cir. 1977) (recognizing that notwithstanding limitations on interest imposed on state banks by Nebraska law, national bank located in Nebraska could legally charge, with respect to credit-card transactions, rates allowed by Nebraska law to small loan companies).

In *Marquette National Bank v. First of Omaha Service Corp.,* 439 *U.S.* 299, 99 *S. Ct.* 540, 58 *L. Ed.* 2d 534 (1978), the Supreme Court relied on the NBA and its most-favored-lender doctrine to allow a national bank chartered in Nebraska to charge its credit-card customers in Minnesota a rate of interest authorized in Nebraska, but prohibited by usury law restrictions in Minnesota. *Id.* at 313-15, 99 *S.Ct.* at 548-49, 58 *L. Ed.* 2d at 545-46. The *Marquette* Court recognized that the "exportation" of interest rates from a national bank's "home state" into a foreign state would "significantly impair the ability of the States to enact effective usury laws," but it found that such impairment "has always been implicit in the structure of the National Bank Act since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates." *Id.* at 318, 99 *S. Ct.* at 550, 58 *L. Ed.* 2d at 548 (citation omitted) (footnote omitted).

The Court, nonetheless, suggested Congressional action would be necessary to check the preemptive effect of the NBA in a time of national bank deregulation, tightened credit availability, and an increasingly nationalized credit-card lending system:

> This impairment may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards.

> But the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court.
>
> [*Id.* at 318-19, 99 *S. Ct.* at 550, 58 *L. Ed.* 2d at 548.]

Marquette does not mandate or encourage an extension of the "most-favored-lender" status to expand the definition of "rates" to include other non-interest rate charges. The national bank's authorized exportation of lending terms in *Marquette* was limited to numerical percentage-rate interest terms. The Court made no mention of the exportation of other credit-card terms, such as late charges, nor did its reasoning or rationale imply that discrete and specialized charges affixed to credit-card loans could be imposed on customers in other states. *See Smiley, supra,* 44 *Cal. Rptr.* 2d at 465 (Arabian, J., dissenting).

In the years following *Marquette,* Congress embarked on a mission to deregulate the banking industry. Interest rates soared, and while national banks could charge interest at a rate tied to the federal discount rate, state banks were constrained by local usury laws. *See Greenwood Trust, supra,* 971 F.2d at 826. Congress sought to rectify that obvious inequity by enacting the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 *U.S.C.A.* § 1831d (DIDA). *Ibid.* The language of section 521 of DIDA essentially mirrors that of section 85 of the NBA. Courts and federal agencies have interpreted section 521 as conferring on federally-insured state banks the same insulation from state usury laws that national

banks have enjoyed under the NBA. *Id.* at 826-27 (concluding that Section 521 permits federally-insured state banks to "export" interest rates); *Vanderweyst v. First State Bank*, 425 *N.W.*2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most favored lender" status), *cert. denied*, 488 *U.S.* 943, 109 *S. Ct.* 369, 102 *L. Ed.* 2d 359 (1988).

The legislative history of DIDA is instructive to our understanding of Congress' general understanding of interest and its intent with respect to the notion of interest contained in the NBA. *E.g. Copeland v. MBNA America Bank, N.A.*, ___ *Colo.* ___ (1995) (slip op. at 14). Although the NBA was enacted 100 years earlier, the same tensions, namely parity between federal and state lenders and preservation of local usury laws, were present and these conflicting considerations generated substantial concerns surrounding the passage of the earlier banking statute.

The record of Congressional debate and deliberation concerning the enactment of DIDA strongly supports the understanding that preemption of credit-card regulation under DIDA is confined to traditional numerical interest rates. The central unifying purpose of DIDA was to provide for increased access to home mortgage loans. Section 501 of DIDA provided for preemption of state usury limits on mortgage loans in a manner virtually identical to the treatment of other loans (including credit-card agreements) in Title V of the Act, which contains section 521.

The Senate Report of deliberations over section 501 of DIDA restricts preemption and expressly reserves the regulation of "late charges" to the states.

> In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.
>
> [S. Rep. No. 96-368, 96th Cong., 2d Sess. 19, *reprinted in* 1980 *U.S. Code Cong. and Ad. News*, Vol. 2, 236, 255.]

Subsequent legislative history links preemption concerns in section 501 both to the consideration of section 521, and to DIDA in its entirety as passed on March 27-28, 1980. Notably, Congress passed section 501 at the same time, and the same title (Title V) of the same act, as section 521.

During the discussion on the Senate floor of the various bills that figured in the development of DIDA, Senators Pryor and Bumpers proposed an amendment, S. 1988, to give state-chartered institutions "competitive equality" with national banks by allowing them to charge interest at one percent above the federal discount rate. 125 *Cong. Rec.* 30655 (1979). Senator Proxmire, floor manager of the Senate bills under discussion, and chairman of the Senate Banking Committee, understood the proposed amendment to override state usury laws and emphasized that there was "a sharp division and difference of opinion in the Senate." *Id.*

Separate hearings on the Pryor-Bumpers initiative, S. 1988, 96th Cong. 1st Sess, (1979) were held December 17, 1979, and though it was not reported out of committee, the bill's language was substantially incorporated into

House Bill 4986, H.R. 4986, 96th Cong., 1st Sess. (1979), which was, in turn, enacted as DIDA. William M. Burke & Alan S. Kaplinsky, *Unraveling the New Federal Usury Law*, 37 *Bus. Law.* 1079, 1096-97 and n.102 (1982).

A fair reading of the legislative history indicates that Congressional concern was focused with particularity on numerical or percentage interest rates. In introducing S. 1988, Senator Pryor noted, "A national bank may charge one percent above the Federal discount rate, notwithstanding any State laws setting an interest-rate ceiling . . . [which] obviously discriminates in the strongest possible way against State banks." 125 *Cong. Rec.* 30655 (1979). The great bulk of the subsequent committee testimony and discussion indicates that the proposed preemption amendment was limited because, in Senator Pryor's words, it "would merely allow State chartered, federally insured banks . . . to charge the same interest rate as national banks." *Id.* In fact, there were only two references to wider displacement of state law though expansion of the "most-favored-lender doctrine." Senator Bumpers, co-sponsor of the preemption amendment, confined his remarks to numerical interest rate disparities and remarked pointedly, "I do not think it is particularly healthy to be overriding state law." *Id.*

Post-DIDA legislative history tends to confirm the conclusion that Congress in 1980 did not intend to bar states from prohibiting late fees by credit-card issuers. In 1981 and in 1983-84 the Senate (but not the House) passed amendments to DIDA which would have expanded preemption of state usury laws, but would have expressly exempted late charges from preemption. *Greenwood Trust, supra,* 776 *F. Supp.* at 31 (citing *Hearings on S. 730 Before the*

Senate Committee on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. (April 12, 1983); Hearings on S. 1720, 1981.[1] The failed S. 730 bill also expressly granted states the right to override preemption.

Thus, the fact that Congress was specifically concerned about effecting a preemption limited to numerical interest rates is significant. If we cannot attribute to legislative initiative of 15 years ago the intent to include

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[1] S. 730, the "Credit Deregulation and Availability Act of 1983," would have amended Title V of DIDA to provide, in relevant part, as follows:

> Sec. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be charged, taken, received or reserved shall not apply to any extension of consumer credit made by the creditor.
>
> Sec. 532. (a) As used in this part –
>
> (1) The term "covered charges" means –
>
> (A) interest, discount, points, a time price differential, or any similar fees, charges, or other compensation paid to the creditor and arising out of the credit agreement or transaction for the use of credit or credit services. *The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor, including without limitation the fact that the obligation is not repaid in accordance with the payment schedule. . . .*
>
> [129 *Cong. Rec.* S. 17045-17046 (November 18, 1983) (emphasis added).]

discrete, specialized charges within a definition of interest, we cannot ascribe that expansive definition to a legislative initiative that occurred over 100 years earlier. That is especially so when the later statute substantially paralleled the language of the former, and it was passed in an effort to give federally-insured state banks status equal to national banks that had enjoyed a superior status since the enactment of the earlier act. Thus, it would be contrary to common sense to conclude that in enacting the NBA, Congress contemplated an open-ended and expansive concept of interest that was light years from the traditional understanding of a fixed, basic percentage rate applied to an unpaid loan balance. Or that, correlatively, it intended to prohibit states from regulating specific terms and conditions of loans and preventing lenders from charging late-payment fees.

II

Defendant relies on case law from other jurisdictions to support its expansive interpretation of "interest", specifically, *Greenwood Trust, supra*, 971 F.2d 818 and *Tikkanen v. Citibank (South Dakota), N.A.*, 801 *F. Supp.* 270 (D. Minn. 1992). We find, however, that the reasoning expressed in the *Greenwood Trust* line of cases and the authorities cited by the *Greenwood Trust* court are unpersuasive and do not support the conclusion that Congress intended to include non-interest rate charges in its understanding of interest.

Greenwood Trust held that prior case law supported the notion that federal common law construes interest to encompass a variety of lender-imposed fees and financial

requirements that are independent of a numerical percentage rate. 971 F.2d at 829 (citing *American Timber & Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982); *Fisher v. First Nat'l Bank*, 548 F.2d 255, 258-61 (8th Cir. 1977); *Panos v. Smith*, 116 F.2d 445, 446-46 (6th Cir. 1940); *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.), *cert. denied*, 290 *U.S.* 685, 54 *S. Ct.* 121, 78 *L. Ed.* 590 (1933); *Nelson v. Citibank (South Dakota) N.A.*, 794 *F. Supp.* 312, 318 (D. Minn. 1992)). Inimical to the holding in *Greenwood Trust*, a careful examination of the cases cited does not establish that Congress intended to include late-payment fees within a federal definition of interest under either section 85 or section 521.

Contrary to the *Greenwood Trust* court's interpretation, *American Timber & Trading Co., supra*, did not hold that a compensating-balance requirement was interest under section 85. Rather, the court held that a compensating-balance requirement reduces the principal amount of a loan for purposes of calculating effective interest. 690 F.2d at 787-88. In addition, *Fisher, supra*, did not expressly hold that cash-advance fees were interest under section 85. In that case, the plaintiff challenged the periodic interest and cash-advance fees charged by an out-of-state national bank. 548 F.2d at 256. The court applied the most favorable laws covering any class of lenders in the bank's home state, which permitted certain lenders to charge 30% interest on a balance under $300, and held that the charges were not usurious. *Id.* at 258-61. The court did not even discuss the distinction between periodic interest rates and the flat fees charged.

In *Panos, supra*, the court did not hold that mortgage taxes and recording fees were interest under section 85.

Rather, the court held that such charges, which were deducted from the principal received by the borrower, reduced the principal amount of a loan for purposes of calculating effective interest. 116 F.2d at 446-47.

In *Cronkleton, supra,* the court did not conclude that a bonus or commission was interest under section 85. The Eighth Circuit's holding (in relevant part) was limited to a modification of the district court's award of damages for usury under the NBA. The court's opinion does not provide a detailed account of the facts. However, it appears that in February 1926, the defendant, a national bank, loaned $55,000 to the plaintiffs. 66 F.2d at 385. The contractual periodic rate of interest was not usurious. *Ibid.* But, in November 1930, plaintiffs paid to the bank an additional $1,000. *Ibid.* Although the district court "made no findings as to bonuses paid," the court characterized the additional payment as a bonus or commission. *Id.* at 386. The court then noted that "in determining the rate 'reserved' or 'charged' . . . the taking of a 'bonus' or 'commission' . . . may enter in to render an otherwise lawful rate unlawful and usurious." *Id.* at 387.

The *Greenwood Trust* court suggested that *Nelson, supra,* decided three months earlier, held that late-payment fees were interest under section 85. 971 F.2d at 829. However, *Nelson* expressly disclaimed that conclusion. 794 *F. Supp.* at 320 ("the question of whether national banks may export terms other than periodic interest charges goes to the merits of the case; deciding that question on a motion to remand is inappropriate"). The court held only that the defendant's claim that section 85 preempted plaintiffs' state law claims raised a substantial federal question. *Id.* at 315-16.

The court in *Greenwood Trust* also cited several cases to support the proposition that section 85 "adopts the entire case law of [a state bank's home] state interpreting the state's limitations on usury; it does not merely incorporate the numerical rate adopted by the state." 971 F.2d at 829 (citing *First Nat'l Bank v. Nowlin,* 509 F.2d 872, 876 (8th Cir. 1975); *accord Roper v. Consurve, Inc.,* 777 F. Supp. 508, 510-11 (S.D. Miss. 1990), *aff'd,* 932 F.2d 965 (5th Cir.) (table), *cert. denied,* ___ U.S. ___, 112 *S. Ct.* 181, 116 *L. Ed.* 2d 142 (1991); *Daggs v. Phoenix Nat'l Bank,* 177 *U.S.* 549, 555, 20 *S. Ct.* 732, 735, 44 *L. Ed.* 882 (1900); *Union Nat'l Bank v. Louisville, N.A. & C. Ry.,* 163 *U.S.* 325, 331, 16 *S. Ct.* 1039, 1042, 41 *L. Ed.* 177 (1896); *Bartholomew v. Northampton Nat'l Bank,* 584 F.2d 1288, 1295 (3d Cir. 1978); *McAdoo v. Union Nat'l Bank,* 535 F.2d 1050, 1055-58 (8th Cir. 1976); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.,* 464 F.2d 855, 861-64 (6th Cir. 1972)). Those cases, however, do not demonstrate that Congress intended to incorporate a state definition of interest that would authorize states unilaterally to incorporate non-percentage rate charges into an exportable definition under section 85. Moreover, none of those cases involve a definition of interest for exportation purposes where the definition varied between states.

Nowlin, supra, exemplifies the *Greenwood Trust* court's misplaced reliance on previous cases construing the NBA. In *Nowlin,* a national bank in Arkansas loaned money to the plaintiff, who agreed to repay the loan in installments. 509 F.2d at 874. Instead of amortizing the loan over the agreed term, the bank "discounted" the notes by 8%; that is, the bank gave the plaintiff the requested sum, but an additional 8% for every year of the notes' term

was immediately added to the outstanding principal amount. *Ibid.* The plaintiff then had to repay the adjusted principal amount in equal payments over the term. *Ibid.* Because all interest was calculated up-front based on the initial loan amount, instead of being calculated periodically on a declining principal balance, the national bank achieved an effective yield of nearly 16%. *Ibid.*

The bank did not dispute that Arkansas considered usurious interest rates over 10%. *Id.* at 876. Furthermore, the bank did not dispute that a state bank could not "discount" notes in a like manner because Arkansas case law defined interest for purposes of its usury laws as "effective yield." *Ibid.* However, the bank argued that because it was a national bank, it was subject only to section 85, which defined interest narrowly to include only percentage rates charged, not effective yields. *Ibid.* Because its 8% discount rate was less than the 10% Arkansas-usury rate, the bank argued that it did not violate the NBA. *Ibid.*

The court rejected the bank's arguments. After discussing the objectives of section 85, the court held that such a narrow interpretation would be inconsistent with Congress' desire to foster competitive equality between state and national banks. *Id.* at 880. Thus, the court held, Arkansas' definition of interest was incorporated into section 85. *Ibid.*

Contrary to the *Greenwood Trust* Court's conclusion, *Nowlin* does not offer an expanded definition of the term "rate," but rather shows only that calculation of chargeable interest rates must take "the case law of the state" into account. The state law regarding discounting was

given substantial weight because discounting, unlike late-fee charges, directly affects the numerical interest rate by altering the percentage rate over time. It is noteworthy that the *Nowlin* decision involved the intra-state, not inter-state, application of Arkansas' definition of interest. Thus, it said nothing about exporting that definition to a foreign state where state-usury laws are more restrictive. Moreover, the case should be read as a judicial attempt to protect state usury laws at the expense of the federal most-favored-lender doctrine.

Defendant also refers, as does the dissent, to *Smiley v. Citibank, supra,* 44 *Cal. Rptr.*2d 441 (1995), to support its position that "interest" under section 85 includes late charges. *Post* at ___ (slip op. at 4). Similar use is made of *Copeland v. MBNA America Bank, N.A., supra,* ___ *Colo.* ___ (1995). The majority in *Smiley* bases that conclusion in large measure on its understanding of historical legal usage. *Smiley, supra,* at 449-51. *See also Copeland, supra,* at ___ (slip op. at 11-13) (same). In our view, however, interest in its historical setting is limited to a periodic charge expressed as a percentage of a principal balance due. See discussion, *supra,* at 25-28. The majority in *Smiley* also concluded that if interest does not include late charges then a state could discriminate against a national bank to make it unprofitable for it to lend money in that state. *Smiley, supra,* at 451. However, a state cannot discriminate against a national bank by permitting state banks to charge late fees or higher late fees while prohibiting a national bank from charging those fees. See discussion, *infra* at 38-41. *See Smiley, supra,* at 470 (George, J., dissenting) (noting that it has been established since the early 1800's that even in the absence of a specific federal

statutory prohibition a state may not discriminate against a federal instrumentality either in the enactment or enforcement of state laws). Thus, the most-favored-lender doctrine serves to eliminate discrimination without distorting or extending the meaning of interest to include charges that Congress neither expressly nor implicitly incorporated in the definition of interest.

III

Defendant, as well as the dissent, cites a recently promulgated proposed interpretive ruling by the Office of the Comptroller of the Currency (OCC), the agency charged with enforcement of the NBA, as evidence that late fees constitute interest for purposes of the NBA. *Post* at ___ (slip op. at 16). The soundness of this ruling, and its value as authority, are greatly undermined when placed in the context of conflicting OCC rulings.

It is well settled that in general an agency's interpretation of a statute it is charged with enforcing is entitled to substantial deference, *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 *U.S.* 837, 843-45, 104 *S. Ct.* 2778, 2781-83, 81 *L. Ed.* 2d 694, 703-04 (1984); *EPA v. National Crushed Stone Ass'n*, 449 *U.S.* 64, 83, 101 *S. Ct.* 295, 307, 66 *L. Ed.* 2d 268, 283 (1980) (citing *Udall v. Tallman*, 380 *U.S.* 1, 16, 85 *S. Ct.* 792, 801, 13 *L. Ed.* 2d 616 (1965)), and must in general be upheld even if that interpretation is not the only permissible one or even the most reasonable. *Grocery Town Market, Inc. v. United States*, 848 *F.*2d 392, 396 (3d Cir. 1988). There are, however, exceptions to the general rule.

Far less than the usual amount of deference to an agency interpretation is appropriate when that agency has failed to adopt a consistent interpretation in administering the statute in question. *INS v. Cardoza-Fonseca*, 480 *U.S.* 421, 446 n.30, 107 *S. Ct.* 1207, 1221 n.30, 94 *L. Ed.* 2d 434, 457 n.30 (1987) (citing *Watt v. Alaska*, 451 *U.S.* 259, 273, 101 *S. Ct.* 1673, 1681, 68 *L. Ed.* 2d 80 (1981); *General Elec. Co. v. Gilbert*, 429 *U.S.* 125, 143, 97 *S. Ct.* 401, 411-12, 50 *L. Ed.* 2d 343 (1976)).

"It is emphatically the province and duty of the judicial department to say what the law is." *Marbury v. Madison*, 5 *U.S.* (1 Cranch) 137, 177, 2 *L. Ed.* 60 (1803). Statutory construction is ultimately a judicial function. *See, e.g., SEC v. Sloan*, 436 *U.S.* 103, 118, 98 *S. Ct.* 1702, 1712, 56 *L. Ed.* 2d 148, 161 (1978); *Federal Maritime Comm. v. Seatrain Lines, Inc.*, 411 *U.S.* 726, 745-46, 93 *S. Ct.* 1773, 1784-85, 36 *L. Ed.* 2d 620, 633-34 (1973). Indeed, "one of the Judiciary's characteristic roles is to interpret statutes." *Japan Whaling Ass'n v. American Catacean Soc'y*, 478 *U.S.* 221, 230, 106 *S. Ct.* 2860, 2866, 92 *L. Ed.* 2d 166, 179 (1986). Accordingly, the Supreme Court in *Chevron, supra*, did not state that silence or ambiguity in a statute automatically requires a court to delegate its entire interpretive responsibility to an agency, especially when an agency's interpretation is contrary to the purpose of the statute or inconsistent. *See West v. Bowen*, 879 *F.*2d 1122, 1138 (3d Cir. 1989) (Mansmann, J., concurring and dissenting).

Courts have found consistency or lack thereof in an agency interpretation to be crucial in determining the degree of deference to be afforded that interpretation. *See, e.g., INS v. Cardoza-Fonseca, supra* (rejecting deference to

Board of Immigration Appeals due to years of inconsistent positions); *Director, Office of Workers' Compensation Programs v. Mangifest*, 826 *F.*2d 1318, 1319-20 (3d Cir. 1987) (finding "ambiguities and inconsistencies in the Director's interpretation of . . . regulations . . . sufficiently great to preclude deference"); *Revak v. National Mines Corp.*, 808 *F.*2d 996, 1002 (3d Cir. 1986) (rejecting deference arguments due to inconsistent agency interpretation of statute); *Disabled in Action v. Sykes*, 833 *F.*2d 1113, 1117-19 (3d Cir. 1987), *cert. denied*, 485 *U.S.* 989, 108 *S. Ct.* 1293, 99 *L. Ed.* 2d 503 (1988). There is a great difference between flexibility and vacillation. Accordingly, judicial deference to administrative rulings should be cast on a sliding scale whereby the usual respect for agency determination diminishes as apparent inconsistencies surmount. *West, supra*, 879 *F.*2d at 1134 (Mansmann, J., dissenting and concurring).

The federal administrative understanding of the meaning of "interest" has wavered. *Cf. Copeland, supra*, ___ *Colo.* at ___ (slip op. at 13) (asserting that "[t]he OCC *consistently* has taken the position that late payment fees are interest" under both section 85 of the NBA and section 521 of the DIDA) (emphasis added). An examination of OCC interpretive letters reveals significant inconsistent administrative treatment of interest with respect to the NBA. As early as 1964, the OCC, responding to an inquiry to define interest under the NBA, stated that "late payment fees . . . would not properly be characterized as interest." *See* Letter by James J. Saxon, Comptroller of the Currency (June 25, 1964), Brief of Petitioner-Defendant at Ex C. (No. 38,817). Then, in 1986, the OCC was asked specifically whether late fees were considered interest

that could be exported under section 85. Letter by Charles F. Byrd, Assistant Director, Legal Advisory Service (May 5, 1986), 1986 *WL* 143937 (O.C.C.). The agency opined that section 85 looks to state law to determine the maximum permissible interest rate, but that federal law determines which charges are "material" to the rate determination. *Id.* at *1. Because courts had not determined whether late fees were material, the OCC refused to provide the answer. *Ibid.*

In 1988, however, the OCC issued Interpretive Letter No. 452, which addressed whether various fees charged by an out-of-state national bank to its credit cardholder in Iowa were material to the determination of the interest rate under Section 85. Letter by Robert B. Serino, Deputy Chief Counsel, Office of the Comptroller of Currency [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 at 78,063 (Aug. 11, 1988). The agency concluded that whether particular fees are material to the interest rate determination under section 85 depends on the laws of a national bank's home state. *Id.* at 78,065-66 (citing Interpretive Ruling 7.7310, 12 C.F.R. § 7.7310(a)).

The OCC recently has affirmed that position. *See* Letter by Peter Liebsman, Assistant Director, Bank Operations and Asset Division (February 26, 1993), 1993 *WL* 501557 at *2 (the "1993 OCC Letter"). However, because the State failed to define "materiality", the 1993 OCC Letter stated that "characteristics of either the loan or the borrower . . . [that are] an integral part of a bank's decision to establish the rate of interest that will be charged" typically are material. *Id.* at *3. Notably, the OCC opined that charges such as "late fees, nonsufficient check charges, cash advance fees and attorney fees

appear not to determine the numerical rate of interest to be charged." *Id.* at *4. Because such fees have only an "indirect effect on interest rates in that they may affect the ultimate return on loan proceeds," the agency suggested that absent their inclusion in the home-state's definition of interest, they would not be material, and thus, would not be exportable. *See Ibid.*

The conflicting interpretations, coupled with the logic expressed in the "materiality" standard, convince us that this Court should not forsake its own considered reasoning by relying on an equivocation. It is the responsibility of Congress to depart from the traditional understanding of interest and to express an intent to include non-numerical interest rates in its definition of "interest" under the NBA.

IV

New Jersey's banking statutes also reflect the basic understanding that the notion of interest was conceived and continues to be defined as specific percentage rates, rather than discrete charges, such as late fees, which are not directly related to borrowing money. *N.J.S.A.* 17:13A, which governs installment loan rate advertising, defines interest as follows:

> every charge paid to the lender or contracted for by the lender and the borrower in connection with or as an incident of a loan, whether designated as interest or as a financial charge or otherwise, *except that the term does not include the following charges when made pursuant to law: late or delinquency charges;* attorneys' and collection fees; insurance premiums, including premiums

> for credit life insurance; recording or filing fees, and all other charges which may lawfully be made on loans in addition to interest or finance charges.
>
> [*N.J.S.A.* 17:13A-2(g) (emphasis added).]

Other statutes distinguish late fees from interest by either authorizing or prohibiting certain lending institutions from making such charges. *N.J.S.A.* 17:13-104b specifically authorizes New Jersey credit unions to charge late fees to its members.

> Notwithstanding the provisions of R.S. 31:1-1 to the contrary, a credit union may charge, contract for, and receive interest on loans at a rate or rates agreed to by the credit union and the member. A *credit union may charge late fees* and lawful fees paid to any public officer for filing, recording, or releasing a document, and may charge collection fees, not to exceed 20% of the principle [sic] balance and interest outstanding, which may be added to the principal balance of any loan placed for collection after default thereon.
>
> [*N.J.S.A.* 17:13-104b (emphasis added).]

N.J.S.A. 17:9A governs a banking institution's authority to make check loans and other loans, *N.J.S.A.* 17:9A-59.1 to -59.17, small business loans, *N.J.S.A.* 17:9A-59.25 to -59.39 and loans secured by a deposit, *N.J.S.A.* 17:9A-59.40-63. In defining the amount of interest permitted on each class of loans, the respective statutes specifically include only percentage *rate* interest, not other financial charges. Other charges are provided for in separate sections. For example, *N.J.S.A.* 17:9A-59.6, sets the

rate of interest for advance loans. Later provisions provide for additional fees on advance loans, such as late charges, *N.J.S.A.* 17:9A-59.7, and service charges, *N.J.S.A.* 17:9A-59.8.

On the other hand, New Jersey's RISA prohibits lenders from charging late fees and other financial charges in addition to interest. The statute provides:

> No retail seller, sales finance company, or holder shall charge, . . . directly or indirectly, any further or other amount for costs, charges, insurance premiums, examination, appraisal service, brokerage, commission, expense, interest, discount, fees, fines, penalties or other things of value in connection with . . . retail charge accounts other than the charges permitted by this act. . . .
>
> [*N.J.S.A.* 17:16C.50.]

At the time this case was before the Court, the statute expressly authorized delinquency or late-payment charges on only retail installment contracts. *N.J.S.A.* 17:16C-42(a). On March 7, 1995, however, the statute was amended by *L.* 1995, *c.* 43, § 1, which specifically allows for late-payment charges on retail charge accounts. It provides in pertinent part that:

> The holder of any retail charge account may collect a delinquency or collection charge in an amount not to exceed $10 if provided for in the retail charge account agreement, on any minimum payment which has not been paid in full

> for a period of 10 days after its due date, as originally scheduled.
>
> [*L.* 1995, *c.* 43, § 1.]

The effective date of the amendment was May 29, 1995, 90 days following its enactment. *L.* 1995, *c.* 43, § 2. Thus, for purposes of this appeal, defendant's late-fee charges were still illegal under RISA. This amendment to the statute indicates, however, that the legislature did not intend to include late-fee charges within its definition of interest; rather, it expressly specified when and under what conditions other non-percentage rate charges could be procured by lenders in addition to annual interest rate charges.

Moreover, the regulations governing banking specifically provide for the maximum *rate* of interest to be charged on the issuance of different types of loans. *N.J.A.C.* 3:1-1.1; *N.J.A.C.* 3:1-1.2. These regulations governing interest say nothing about other financial charges, such as late fees. Thus, the manner in which both the Legislature and the Department of Banking have chosen to regulate lender-authorized charges clearly supports the conclusion that late fees are distinct from interest and thus not contained within the accepted definition of interest. The dissent incorporates late fees, and presumably other similar charges, into the notion of traditional interest by homogenizing what the Legislature has meticulously separated. It does so only by obscuring the clear language and structure of the legislative treatment of interest and late fees. *See Post* at ___ (slip op. at 24-28).

The State Bank Parity Act, *N.J.S.A.* 17:13B-1 to -2, authorizes New Jersey banks to charge the same "rate of

interest" charged by credit unions. *N.J.S.A.* 17:13B-2 provides:

> Notwithstanding any provisions of R.S. 31:1-1 or any other statute to the contrary, any bank, savings bank, savings and loan association or credit union may charge a *rate* of interest on any class or type of loan at the rate of interest permitted to any other lender by the laws of this State on that class or type of loan.
>
> [*N.J.S.A.* 17:13B-2 (emphasis added).]

The Assembly Banking and Insurance Committee Statement that accompanied this legislation indicates that the act was intended as a state-bank companion to section 85 of the NBA.

> This legislation would give state chartered banks, savings banks, savings and loan associations, and credit unions the same "most-favored-lender" authority that national banks presently enjoy. . . . In practice, a national bank may charge interest on any type of loan at the highest rate allowed to any lender in the state making any similar type of loan. Thus, in certain cases, national banks may now use the rate permitted to be charged by secondary mortgage loan licensees, small loan companies (this rate will now apply to bank credit cards because of legislation passed last year), or home repair contractors. This legislation, therefore, provides parity to state-chartered institutions.
>
> [Assembly Banking & Insurance Committee, *Statement to Assembly Bill No. 1986* (1981).]

Thus, while the Act provides for parity between the rates of interest charged by both banks and credit unions, the act does not explicitly authorize banks to charge other types of fees. Furthermore, there is no indication that the Legislature implicitly intended these other fees in the State Bank Parity Act. Indeed, the fact that the Legislature has passed separate statutes that expressly authorize the imposition of discrete fees and charges, (see discussion, *supra*, at ___ (slip op. at 24-28)), in contrast to interest, underscores the understanding that those types of charges are not contemplated by the State Bank Parity Act. The clearest indication of the Legislature's intent to distinguish between interest rates and late fees is in the language of its recent amendment to RISA, in which it expressly authorizes holders of retail charge accounts, as well as retail installment contracts, to charge late fees. The Legislature obviously enacted this law because it wanted to enable banks and other retail charge-account holders to charge late fees that credit unions were permitted to charge under *N.J.S.A.* 17:13-104b. Had the State Bank Parity Act provided parity between lenders as to specific non-interest rate charges, there would have been no need for the amendment because holders of retail charge accounts would have been entitled, pursuant to the parity act, to charge the late fees that credit unions were authorized to charge. Courts should avoid a construction that would render legislative enactments meaningless. *State v. Reynolds*, 124 *N.J.* 559 (1991). Thus, by excluding discrete charges from the parity act, the Legislature retained flexibility with respect to the non-percentage rate fees different lenders were permitted to charge their customers. For example, retail charge account

holders are limited to a $10 late-fee per default period, while credit unions have no such limitation.

The language of RISA itself indicates the legislative intent to leave room for subsequent legislative initiatives to allow different lenders to make discrete non-percent- age rate charges; it states that a retail seller, sales finance company or holder cannot charge additional fees or charges "other than the charges permitted by this act." Thus, the Legislature, in reserving within the statute the ability to authorize certain charges, has correctly recog- nized that there may be specific reasons for treating dif- ferent lenders differently. For example, there may be specific reasons for allowing a credit union, rather than a bank, to charge late fees. Credit unions are small, individ- ualized lenders which do not cater to a large market. Furthermore, credit unions have a genuine social welfare purpose. In assisting their members they cannot spread costs like banks. Thus, they must be permitted to take actions, such as charging late fees, to help insure their solvency.

The dissent points to a letter from the Department of Banking to support its theory that the State Bank Parity Act includes late fees in its definition of interest. *Post*, at ___ (slip op. at 27-28) (citing Letter from Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994)). Relying on an informal and isolated expression of agency interpretation has limited authoritative weight and does little to buttress its argument. Here, we are not presented with duly promulgated regulations that express legislative intent. *Metromedia, Inc. v. Director, Div. of Taxation*, 97 *N.J.* 313, 331 (1984) (emphasizing that pro- cedural requirements for passage of rules, involving

notice and public participation, are given authoritative weight). Nor are we confronted with even a course of regulatory conduct that reflects a clear and consistent administrative understanding as evidence of an underly- ing legislative intent. *Body-Rite Repair Co., Inc. v. Director, Div. of Taxation*, 89 *N.J.* 540, 545-46 (1982) (holding that practical administrative construction of statute over period of years without interference by Legislature is evidence of conformity with legislative intent and should be given great weight by court). Clearly, a single letter from the Department of Banking does not constitute a settled or widespread course of administrative conduct that can be equated with the interpretive authority of a duly promulgated rule. Moreover, it cannot provide a meaning that is neither expressed in the statute, nor in the legislative scheme governing banking. Our deference does not go so far as to permit an administrative agency under the guise of an administrative interpretation to give a statute any greater effect than is permitted by statutory language. *In re Adoption of N.J.A.C. 7:26B*, 128 *N.J.* 442, 450 (1992) (citation omitted).

This Court has found no legislative authority to sup- port the contention that interest in the context of either the State Bank Parity Act or the NBA encompasses a variety of lender-imposed fees and financial requirements that are independent of a numerical percentage rate. Thus, we can conclude only that neither Congress, in passing the NBA, nor the New Jersey Legislature, through its own parity act, intended to include late fees in its definition of interest for the purpose of preventing discrimination against out-of-state lenders.

V

Defendant argues that although the new RISA amendment is inapplicable to the charges assessed in this case, the fact that New Jersey credit unions were permitted to charge late fees at the time defendant procured those fees, pursuant to the most-favored-lender doctrine, entitled out-of-state national banks, like defendant, to charge late fees. We disagree.

Although a national bank may "borrow" the interest rate from any lending institution in its home state, without regard to whether that institution is actually "competitive" with a national bank, a national bank is not authorized to charge late fees simply because a state credit union is so authorized in a state other than its home state. Inter-state parity, as established in *Marquette*, is commonly identified as the notion that a national bank is entitled to export the interest authorized by its home state to borrowers located in other states that authorize a lower interest rates [sic]. *Marquette, supra*, 439 *U.S.* at 313-14, 99 *S. Ct.* at 548, 58 *L. Ed.* 2d at 545. The defendant seeks to extend this inter-state parity notion by arguing that a foreign national bank lending to customers in New Jersey is entitled to charge the interest authorized by the state in which the bank is located *or* the interest authorized in New Jersey, whichever is higher, and that for purposes of determining what interest can be exported, all of the extra charges authorized by the borrower's state can be included as well. Thus, it argues a foreign national bank can charge late fees because New Jersey credit unions are permitted to charge them and, under the most-favored-lender doctrine, national banks can charge the same interest – in its most expansive form – as any state lender. The

argument, we find, overreaches the federal statutory scheme.

Section 85 of the NBA provides in pertinent part:

> Any [national bank] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, *interest at a rate allowed by the laws of the State, Territory, or District where the bank is located*, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except where by the laws of any State a different rate is limited for banks organized under state laws, *the rate so limited shall be allowed for associations organized or existing in any such state* under this chapter.
>
> [12 *U.S.C.A.* § 85 (emphasis added).]

Section 86 reads in pertinent part:

> The taking, receiving, reserving or charging a rate of interest greater than is allowed by section 85 of this title, when knowingly done, shall be deemed a forfeiture of the entire interest . . . In case the greater rate of interest has been paid, the person by whom it has been paid, . . . may recover back, . . . twice the amount of the interest thus paid. . . .
>
> [12 *U.S.C.A.* § 86.]

For purposes of section 85, a national bank is located either in the place designated in its organizational certificate or in the places in which it has established authorized branches. *Marquette, supra*, 439 *U.S.* at 309 n.21, 99

S. Ct. at 546 n.21, 58 *L. Ed.* 2d at 542-43 n.21. A plain reading of the statute and most cases interpreting it indicate that a national bank is permitted to charge the interest rate of the state in which it is located, *not* the interest rate of the state in which the out-of-state customer is located. *Id.* at 301, 99 *S. Ct.* at 542, 58 *L. Ed.* 2d at 537-38 (ruling that section 85 authorizes a national bank based in one state to charge its out-of-state credit card customers an interest rate on unpaid balances allowed by its home state, when that rate is greater than that permitted by the state of the bank's nonresident customers); *Cades v. H & R Block, Inc.*, 43 *F.*3d 869, 874 (4th Cir. 1994) (determining that Delaware law applied to fix the interest rate when the bank located in Delaware, even though the loan occurred in South Carolina; "section 85, which looks to the interest rates allowed by the state where the bank is located – not where the borrower is located or where the loan transaction may be said to have occurred").

Moreover, there is some indication that it is illegal for a national bank to charge interest in excess of that amount permitted in its home state. In *Panos v. Smith, supra,* 116 *F.*2d 446, the court read sections 85 and 86 together to find that the NBA forbids a national bank to collect a higher rate of interest than is permitted by the law of the state in which it is located. Although none of these cases specifically dealt with a situation where the interest in the state of the customer was higher or more permissive than the national bank's home state, the basic understanding that resort to the higher level of interest would not be allowed is readily inferable from their treatment of the subject.

The theory of the NBA, as applied by federal and state courts, is that the borrower's state usury laws can be discarded because the customer either taking out a loan or using her "lender credit card" partakes in a transaction in the national lender's home state. *See Marquette, supra,* 439 *U.S.* at 318-19, 99 *S. Ct.* at 550, 58 *L. Ed.* 2d at 548 (recognizing that impairment of state usury laws "has always been implicit in the structure of the National Bank Act, since citizens of one state were free to visit a neighboring state to receive credit at foreign interest rates"); *Schumacher v. Lawrence, supra,* 108 *F.2d* 576, 577 (6th Cir. 1940) (stating that the question whether the rate of interest charged by a national bank is usurious is decided according to the law of the state in which the transaction occurs); *Haas v. Pittsburgh Nat'l Bank,* 60 *F.R.D.* 604, 608 n. 3 (W.D.Pa. 1973) (same); *Fisher v. First Nat'l Bank, supra,* 548 *F.*2d at 257 ("A[n] [Iowa] customer using this "lender credit card" . . . communicates or indicates his intention to establish the credit card arrangement with BankAmericard when the lender, through banking channels, receives in the State of Nebraska the draft of the customer."). It is clear that Congress intended that the NBA and DIDA immunize national banks and out-of-state federally insured banks that lend money beyond their home-state's borders from local usury laws that might give local banks a competitive advantage. *E.g., Tiffany, supra,* 85 *U.S.* at 412-13, 21 *L. Ed.* at 863-64 (holding that Congress, by enacting NBA, intended to protect national banks from hostile state usury laws); *Sherman,* 272 *N.J. Super.* at 440 (same); *Hunter,* 272 *N.J. Super.* at 530 (same); 12 *U.S.C.A.* 1831d(a) (permitting State-chartered insured depository institutions to charge interest rates permitted in their

home state "[i]n order to prevent discrimination against State-chartered insured depository institutions"). Thus, the statutes were intended to prohibit states from forcing national banks to charge a lower rate of interest to customers located outside of the national bank's home state than they would be permitted to charge their customers located in the home state.

We do not believe prohibiting national lenders from charging the rate of interest permitted by the laws of a foreign state would be considered discrimination when the national bank was not organized in that state and would not be able to charge higher interest rates except by taking advantage of the laws of the foreign state. New Jersey's RISA does not conflict with the most-favored-lender doctrine in this case, and thus New Jersey should be permitted to prohibit out-of-state lenders from charging late-fees to New Jersey residents, because, at the outset of this case, New Jersey banks were also prohibited from charging those fees. This finding would enable state usury laws to remain vital and controlling over non-interest rate credit terms. Consumer credit protection is a fundamental local interest, long recognized by Congress, and it thus should not be displaced by the sweeping preemption urged by defendant.

Because at the time of this appeal, RISA prohibited both New Jersey and national retail charge account holders from charging late fees, we hold that defendant's late-fee charges violated this state's usury laws and are thus impermissible.

VI

Although the late-fee charges at issue in this case are impermissible under the RISA statute as it existed when those fees were assessed, we acknowledge, as suggested by the parties, that such charges assessed after May 29, 1995 do not appear to be illegal under that statute. As earlier discussed, *supra* at ___ (slip op. at 28.29), the Legislature amended the statute to permit "the holder of any retail charge account [to] collect a delinquency or collection charge" of no more than $10. *L.* 1995, *c.* 43, § 1. Pursuant to the statute, a "holder" is "any person, including a retail seller, who is entitled to the rights of a seller under a retail installment contract or retail charge account." *N.J.S.A.* 17:16C-1(m). A "retail charge account" is

> any account . . . established by agreement which prescribes the terms under which a retail buyer may from time to time purchase or lease goods or services which are primarily for personal, family or household purposes, and under which the unpaid balance thereunder, whenever incurred is payable in one or more installments and under which a time price differential may be added in each billing period as provided herein. Retail charge account also includes all accounts arising out of the utilization by the holder of a credit card . . . issued by a sales finance company, giving the holder the privilege of using the credit card . . . to become a retail buyer in transactions out of which debt arises.
>
> [*N.J.S.A.* 17:16C-1(r).]

Although the statute does not expressly include banks within these definitions, clearly banks have for years

been performing the functions attributable to holders of retail charge accounts. *See N.J.S.A.* 17:3B-4 to -28 (Market Rate Consumer Loan Act) (authorizing New Jersey banks to offer revolving credit plans at an interest rate agreed to by lender and borrower); *N.J.S.A.* 17:9A-59.1 (permitting advance loans by banks). In fact, the statute expressly provides that "any banking institutions authorized to do business in this State, shall be authorized to transact business as a sales finance company." *N.J.S.A.* 17:16C-2. Thus, it appears that the Legislature intended to include banks that issue credit cards within those institutions authorized to assess late charges on overdue charge accounts. Therefore, a bank may contract to charge the delinquency fee on the same basis as any other "holder of any retail charge account" in New Jersey.

Nothing in the statute indicates a legislative intention to allow state banks to charge delinquency fees while prohibiting national banks and federally-insured state banks from assessing those fees. In fact, the statute defines banking institutions generally as "any bank, national banking association, savings bank or federally chartered savings bank authorized to do business in this State". *N.J.S.A.* 17:16C-1(n). There is no distinction between a national banking association and an association under state laws except where the distinction is specifically made by Congress. *Anderson v. First Nat'l Bank*, 54 *F. Supp.* 937 (D.Idaho 1944). States may not discriminate against national banks with respect to general contract terms or charges. *See Anderson Nat'l Bank v. Luckett*, 321 *U.S.* 233 (1944) (national banks are subject to state laws unless those laws infringe upon national banking laws or impose undue burden on performance of

bank's functions); *National State Bank v. Long*, 630 *F.*2d 981, 985 (3d Cir. 1980). Thus, national banks, as well as federally-insured state banks, are permitted to charge the late fees authorized by statute to the same extent as state banks.

However, New Jersey retains the authority to regulate on a non-discriminatory basis all non-interest rate contractual terms and conditions of a bank as a holder of a retail charge account. The Supreme Court has held that state law controls a bank's right to collect its debts.

> [National banks] are governed in their daily course of business far more by the laws of the State than of a nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.
>
> [*National Bank v. Commonwealth*, 6 *U.S.* (9 Wall) 353, 362, 19 *L. Ed.* 70 (1870).]

Thus, it would appear that a national bank and a federally-insured state bank may, as of May 29, 1995, charge a delinquency fee in accordance with the authorization now given by the statute. *See L.* 1995, *c.* 43.

VII

The judgment of the Appellate Division is reversed.

Chief Justice Wilentz and Justices Stein and Coleman join in Justice Handler's opinion. Justice Pollock has filed

a separate dissenting opinion in which Justice Garibaldi joins. Justice O'Hern has also filed a separate dissenting opinion.

SUPREME COURT OF NEW JERSEY
A-102 September Term 1994

MARC SHERMAN, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant-Respondent.

POLLOCK, J., dissenting.

This appeal poses the question whether a national bank located in South Dakota may impose a late charge on a credit-card customer who resides in New Jersey, if South Dakota permits the charge, but New Jersey does not. More specifically, the appeal focuses on whether the definition of "interest" in the National Bank Act (NBA), 12 *U.S.C.A.* § 85 (section 85), includes late charges, and, if so, whether that statute preempts the New Jersey Retail Installment Sales Act of 1960, *N.J.S.A.* 17:16C-1 to -94 (RISA).

In a class-action complaint brought on behalf of himself and other Citibank credit cardholders, petitioner, Marc Sherman, asserts that the RISA precludes defendant, Citibank (South Dakota), N.A. (Citibank), a national banking association located in South Dakota, from imposing late charges on cardholders located in New Jersey. The Law Division granted Citibank's motion to dismiss the complaint with prejudice. The Appellate Division affirmed. 272 *N.J. Super.* 435. The majority reverses. I dissent.

-I-

Because the appeal arises from the grant of Citibank's motion to dismiss, I accept as true all facts alleged in the complaint. *See Bozza v. Vornado, Inc.*, 42 *N.J.* 355, 357-58 (1964). Sherman alleges that in 1989 Citibank sent to him at his New Jersey residence an application, Visa card, and Card Member Agreement. The record, however, does not include copies of these instruments. According to the complaint, the annual percentage-rate finance charge (periodic interest) is 19.8 percent. In addition, a card-holder who does not make the minimum payment within twenty-five days of the due date is subject to a fixed late-payment fee regardless of the amount of the outstanding balance or delinquent payment. Twice Sherman was late in making his monthly payment. Each time, Citibank imposed a late charge.

Sherman claims that the late charges violate various provisions of New Jersey's Consumer Fraud Act, *N.J.S.A.* 56:8-2 and -19, and of the RISA, *N.J.S.A.* 17:16C-50 and -54. The Fraud Act prohibits undisclosed late charges, and the RISA prohibits delinquency charges on revolving credit accounts. He also claims that the late fees constitute a common-law breach of contract and conversion. All claims depend on whether Citibank may impose late charges as interest.

The initial task is to determine the meaning of "interest" in section 85. That section permits national banks to charge borrowers "interest at the rate allowed by the laws of the State . . . where the bank is located." 12 *U.S.C.A.* § 85. South Dakota, the state where Citibank is located, defines "interest" to include late charges: "Interest is the

compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation . . . charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit." *S.D. Codified Laws Ann.* § 54-3-1 (1995). Citibank claims that as a South Dakota bank it may impose late charges on defaulting customers whether those customers are located in South Dakota, New Jersey, or anywhere else.

Sherman, however, relies on the RISA, which permits credit-card issuers to charge periodic interest, but not late fees: "No retail seller, sales finance company, or holder shall charge, . . . directly or indirectly, any further or other amount for costs, charges, insurance premiums, examination, appraisal service, brokerage, commission, expense, interest, discount, fees, fines, penalties or other things of value in connection with . . . retail charge accounts. . . . " *N.J.S.A.* 17:16C-50. He claims that "interest" in section 85 refers to periodic interest, but not to late charges. Consequently, he denies that the RISA conflicts with the NBA.

-II-

Initially dividing the majority and the dissent is the meaning of the word "interest" as used in the NBA. Both agree that "interest" includes periodic interest, the amount paid for the use of money calculated as a percentage of the sum due for a stated period, typically one year. That definition, however, is not exhaustive. The meaning of the word becomes indeterminate at the margins. Webster's Dictionary, for example, accords "interest" seven

definitions, six with subparts. Definition 3(a) defines "interest" as "the price paid for borrowing money generally expressed as a percentage of the amount borrowed paid in one year. . . . " *Webster's Third New International Dictionary* (1976). The use of the adverb "generally" suggests the existence of other definitions. So construed, accepted usage recognizes that "interest" may include charges other than periodic interest. Consistent with that construction, the Supreme Court of California recently concluded that dictionary definitions of "interest" "then current in American legal usage" at the time of the passage of the NBA are broad enough to include late charges. *Smiley v. Citibank (South Dakota) N.A.*, 44 *Cal. Rptr.* 2d 441, 450-51 (1995).

More relevant than the meaning that lexicographers assign to statutory terms is the meaning assigned by the Legislature. To bridge the gap between dictionary definitions and legislative intent, the California Supreme Court apparently assumed that Congress consulted the dictionaries cited in *Smiley*. Dictionaries, however, are not essential to the judicial search for the meaning of statutory terms. *Cabnell v. Markham*, 148 *F.*2d 737, 739 (2d Cir. 1945). To illustrate, when deciding that "interest" in the NBA includes late charges, the Colorado Supreme Court recently concluded "that the common dictionary definitions are not sufficiently precise to settle the question before us." *Copeland v. MBNA America, N.A.*, ___ *Colo.* ___ (1995) (slip op. at 9).

Absent an express statutory definition, courts may glean the meaning of legislative language from sources such as statutory history, purpose, and structure. In ascertaining the meaning of a statutory term, a court's

task is not to create its own definition, but to ascertain the definition intended by the Legislature. *E.g.*, *Norfolk & Western Ry. Co. v. American Train Dispatchers Ass'n*, 499 *U.S.* 117, 128, 111 *S. Ct.* 1156, 1163, 113 *L. Ed.* 2d 95, 106-07 (1991); *Roig v. Kelsey*, 135 *N.J.* 500, 515 (1994). The NBA does not expressly define "interest." Nor does a fair reading of the legislative history of the statute disclose the intended meaning of that term. Accordingly, I search elsewhere for the word's meaning in the NBA.

The early history of national banking sheds some light on congressional intent in the NBA. Before enacting the NBA, Congress twice had tried unsuccessfully to create a Bank of the United States. Each time, however, states'-rights advocates defeated attempts to renew the Bank's charter. *See* John J. Knox, *A History of Banking in the United States* 35-48, 51-71 (1900) (discussing creation and dissolution of Bank of the United States and Second Bank of the United States); Bray Hammond, *Banks and Politics in America* 197-226, 369-450 (1957) (same). Then, in 1864, responding to the economic turmoil created by the Civil War, Congress adopted the NBA. Among other things, the NBA re-established a system of national banks. *See* Knox, *supra*, at 91-111 (discussing NBA); Hammond, *supra*, at 718-34 (same). To overcome local prejudice in favor of state banks, Congress included section 85. By mandating interest-rate parity in section 85, Congress sought to provide a level playing field for national banks throughout the United States. *See* Knox, *supra*, at 235-69. Although helpful, the history of the NBA is not dispositive of the meaning of interest in the NBA. *Copeland*, *supra*, ___ *Colo.* at ___ (slip op. at 10).

The United States Supreme Court first construed section 85 in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 21 *L. Ed.* 862 (1873). The plaintiff, Tiffany, challenged the legality of the ten-percent interest rate charged to Missouri borrowers by the defendant, National Bank of Missouri. Missouri's usury laws limited to eight percent the interest rate that state-chartered banks could charge but allowed non-bank lenders to charge interest at a rate of ten percent. *Id.* at 411, 21 *L. Ed.* at 863. Reasoning that section 85 permitted the defendant national bank to charge interest at a "rate allowed by the laws of [Missouri]", the Court held that the bank could charge the highest interest rate that could be charged by any lender in that state. *Id.* at 411-13, 21 *L. Ed.* at 863-64. In so holding, the Court required states to treat national banks as a "most favored lender." *Id.* at 413, 21 *L.Ed.* at 864. Although the Court acknowledged that its holding might disadvantage state-chartered banks, it relied on the overriding congressional intent to create a strong national banking system immune from unfriendly state legislation. *Id.* at 412-13, 21 *L. Ed.* at 863-64. "National banks," the Court declared, are "national favorites." *Id.* at 413, 21 *L. Ed.* at 864.

Over a century later, the Court revisited section 85 in *Marquette National Bank v. First of Omaha Service Corp.*, 439 *U.S.* 299, 99 *S. Ct.* 540, 58 *L. Ed.* 2d 534 (1978). The plaintiff, Marquette National Bank of Minnesota (Marquette), challenged the interest rate charged by a Nebraska national bank to Minnesota credit cardholders. Minnesota law prohibited banks in that state from charging more than twelve percent on credit-card balances, but allowed them to charge an annual fee up to $15. *Id.* at

302-03, 99 *S. Ct.* at 542-43, 58 *L. Ed.* 2d at 538. Nebraska law, however, allowed banks to charge up to eighteen percent on outstanding credit-card balances below $1,000. *Id.* at 302, 99 *S. Ct.* at 542, 58 *L. Ed.* 2d at 538. First National Bank of Omaha (Omaha Bank), a national bank chartered in Nebraska, charged eighteen percent interest on outstanding balances of Minnesota credit cardholders. *See id.* at 304, 99 *S. Ct.* at 543, 58 *L. Ed.* 2d at 539. Marquette claimed it was losing customers to Omaha Bank because "Marquette was forced by the low rate of interest permissible under Minnesota law to charge a $10 annual fee for the use of its credit cards." *Ibid.*

The Court determined that although the cardholders lived and made credit-card purchases in Minnesota, Omaha Bank was "located" in Nebraska. *Id.* at 310-13, 99 *S. Ct.* at 546-48, 58 *L. Ed.* 2d at 543-45. Consequently, Omaha Bank could charge the favorable Nebraska rate to its customers in Minnesota. *Id.* at 313-14, 99 *S. Ct.* at 548, 58 *L. Ed.* 2d at 545. As in *Tiffany, supra,* 85 *U.S.* at 412-13, 21 *L. Ed.* at 863-64, the Court noted the clear congressional intent to favor national banks, even at the expense of state banks. *Marquette Nat'l Bank, supra,* 439 *U.S.* at 314-18, 99 *S. Ct.* at 548-50, 58 *L. Ed.* 2d at 545-48.

Although *Tiffany* and *Marquette* discussed permissible rates of interest under section 85, they did not define "interest." Recent federal decisions, however, illuminate the meaning of interest in section 85. *See Greenwood Trust Co. v. Massachusetts*, 971 *F.* 2d 818 (1st Cir. 1992), *cert. denied*, ___ *U.S.* ___, 113 *S. Ct.* 974, 122 *L. Ed.* 2d 129 (1993); *Tikkanen v. Citibank (South Dakota), N.A.*, 801 *F. Supp.* 270 (D. Minn. 1992).

Greenwood Trust involved a federally-insured state bank chartered in Delaware that issued credit cards throughout the United States, including Massachusetts. 971 *F.* 2d at 821. The bank, Greenwood Trust Company, imposed late charges on its delinquent credit-card customers. Delaware law, like South Dakota law, characterizes late charges as "interest." *Id.* at 829. The state claimed that Massachusetts' consumer-protection law, like the RISA, prohibited late charges. *Id.* at 821. Greenwood Trust argued, however, that by reference to the law of Delaware, the Depositary Institutions Deregulation and Monetary Control Act of 1980 (DIDA) authorized it to charge late fees as interest.

Section 521 of the DIDA grants the same protection to federally-insured state banks that section 85 of the NBA provides to national banks. Section 521 provides that any federally-insured state bank may,

> notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State . . . where the bank is located, whichever may be the greater. . . .
>
> [12 *U.S.C.A.* § 1831d(a).]

The United States Court of Appeals for the First Circuit ruled that under section 521 Greenwood Trust

could charge its Massachusetts cardholders the highest interest rate allowed by Delaware law. *Greenwood Trust, supra,* 971 *F.* 2d at 827. The court determined that both Delaware's express statutory provision, *Del. Code Ann.* tit. 5, § 950 (1994), and federal common law support a broad definition of "interest" that includes late fees. 971 *F.* 2d at 829-30 (citing *American Timber & Trading Co. v. First Nat'l Bank,* 690 *F.* 2d 781, 787-88 (9th Cir. 1982) (compensating balance requirement); *Fisher v. First Nat'l Bank,* 548 *F.* 2d 255, 258-61 (8th Cir. 1977) (cash-advance fee); *Panos v. Smith,* 116 *F.* 2d 445, 446-47 (6th Cir. 1940) (mortgage, taxes, and recording fees); *Cronkleton v. Hall,* 66 *F.* 2d 384, 387 (8th Cir.) (bonus or commission), *cert. denied,* 290 *U.S.* 685, 54 *S. Ct.* 121, 78 *L. Ed.* 590 (1933); *Nelson v. Citibank (South Dakota) N.A.,* 794 *F. Supp.* 312, 318 (D. Minn. 1992) (late fees)). Thus, the court concluded that for purposes of section 521, "interest" includes late fees, and that Greenwood Trust could "export" those charges authorized by Delaware law to Massachusetts. *Greenwood Trust, supra,* 971 *F.* 2d at 831.

The vast majority of state and federal courts have followed *Greenwood Trust. E.g., Ament v. PNC Nat'l Bank,* 849 *F. Supp.* 1015 (W.D. Pa. 1994); *Watson v. First Union Nat'l Bank,* 837 *F. Supp.* 146 (D.S.C. 1993); *Goehl v. Mellon Bank,* 825 *F. Supp.* 1239 (E.D. Pa. 1993); *Smiley, supra,* 44 *Cal. Rptr.* 2d at 453; *Stoorman v. Greenwood Trust Co.,* 888 *P.* 2d 289 (Colo. Ct. App.), *rehearing denied,* ___ *Colo. Ct. App.* ___ (1994), *cert. granted,* ___ *Colo.* ___ (1995); *Copeland, supra,* ___ *Colo.* ___; *Sherman, supra,* 272 *N.J. Super.* 435; *Hunter v. Greenwood Trust Co.,* 272 *N.J. Super.* 526 (App. Div. 1994).

Tikkanen, supra, 801 *F. Supp.* 270, reached the same conclusion under section 85 as *Greenwood Trust* had reached under section 521. In *Tikkanen,* which is virtually identical to this appeal, the plaintiff argued that section 85's definition of interest was restricted to numerical periodic interest rates and did not include late-payment charges authorized by South Dakota, the defendant national bank's home state. 801 *F. Supp.* at 277. The federal district court held, however, that interest under section 85 was not limited to percentage-rate charges and could include fixed late fees. *Id.* at 276-78. Although the court did not announce a federal definition of interest that included late fees, it held that if a national bank's home state defines interest to include such fees, then the bank may "export" those fees under section 85. *Id.* at 279.

Rejecting the *Greenwood Trust* and *Tikkanen* line of cases, lower courts in Pennsylvania have held that "interest" does not include late-payment fees. *Mazaika v. Bank One, Columbus, N.A.,* 653 *A.* 2d 640 (Pa. Super. 1994), *appeal granted,* 659 *A.*2d 557 (Pa. 1995); *Gadon v. Chase Manhattan Bank,* 653 *A.* 2d 697 (Pa. Super. 1995) (following *Mazaika*). One United States District Court has reached a similar conclusion. *Copeland v. MBNA America, N.A.,* 820 *F. Supp.* 537 (D. Colo. 1993) (denying federal jurisdiction based on complete preemption defense because "ordinary meaning" of interest does not encompass late fees).

In *Mazaika, supra,* 653 *A.* 2d at 646, a Pennsylvania intermediate appellate court stated that "[i]t would appear beyond peradventure that the plain and ordinary meaning of the term 'interest' or 'interest rate' does not include late fees, . . . or the like which are not levied on a percentage basis." I find, however, that the meaning of

"interest" and "rate of interest" are not as plain as the *Mazaika* court found them. As the OCC has concluded, *infra* at 16-17, interest could include all charges for the "use or forbearance of money," including late fees. *See Brown v. Hiatts,* 82 *U.S.* (15 Wall.) 177, 185, 21 *L. Ed.* 128, 131 (1872).

-III-

The modern history of banking has been one of expanding regulation. Banks are subject to regulation by multiple federal agencies. The Comptroller of the Currency, 12 *U.S.C.A.* § 1; the Federal Housing Finance Board, 12 *U.S.C.A.* § 422a; the National Credit Union Administration, 12 *U.S.C.A.* § 1752a; the Federal Deposit Insurance Company, 12 *U.S.C.A.* § 1811; the Office of Thrift Supervision, 12 *U.S.C.A.* § 1462a; and the Board of Governors of the Federal Reserve System, 12 *U.S.C.A.* § 248, all regulate various aspects of banking. In addition, banks often are subject to dual regulation by state banking authorities.

With banking, as with other heavily-regulated commercial activities, Congress has recognized that it cannot maintain an efficient regulatory system through constant recourse to the legislative process. *See* Kenneth C. Davis & Richard J. Pierce, Jr., *Administrative Law Treatise* § 3.1 (3d ed. 1994) ("It is impossible to draft a statute with sufficient precision and foresight to resolve each of the hundreds of issues that are likely to arise during the life of the statute."); Cass R. Sunstein, *Law and Administration*

after Chevron, 90 *Colum. L. Rev.* 2071, 2088 (1990) ("Congress is unable to amend every statute to account for- . . . changes. . . . "). Consequently, it has authorized administrative agencies to implement specific congressional objectives. When Congress delegates authority to an administrative agency, the judicial role is not to pass on the wisdom of an agency's decision, but to assure that the agency has not abused its delegated authority. Davis & Pierce, *supra*, at § 3.3; Antonin Scalia, *Judicial Deference to Administrative, Interpretations of Law*, 1989 *Duke L.J.* 511, 516; Richard J. Pierce, Jr., *Chevron & Its Aftermath: Judicial Review of Agency interpretations of Statutory Provisions*, 41 *Vand. L. Rev.* 301, 307-08 (1988); Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 *Yale J. on Reg.* 283, 300-04 (1986).

Absent clear indicia of legislative intent, courts often look for guidance to the administrative agency entrusted with the regulation of matters covered by a statute. *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. ___, ___, 115 *S. Ct.* 810, 813-14, 130 *L. Ed.* 2d 740, 748 (1995); *Chevron, U.S.A., Inc. v. NRDC*, 467 *U.S.* 837, 842-44, 104 *S. Ct.* 2778, 2781-83, 81 *L. Ed.* 2d 694, 702-03 (1984); *Blum v. Bacon*, 457 *U.S.* 132, 141, 102 *S. Ct.* 2355, 2361, 72 *L. Ed.* 2d 728, 736 (1982); *Lammers v. Board of Educ.*, 134 *N.J.* 264, 274 (1993); *Metromedia, Inc. v. Director, Div. of Taxation*, 97 *N.J.* 313, 327 (1984). In *Nationsbank of North Carolina, N.A., supra*, 513 *U.S.* at ___, 115 *S. Ct.* at 813, 130 *L. Ed.* 2d at 747, the United States Supreme Court recently reiterated:

> " 'It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of the banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.' " *Clarke v. Securities Industry Ass'n*, 479 *U.S.* 388, 403-404, 93 *L. Ed.* 2d 757, 107 *S. Ct.* 750, 771-72 (1987) (quoting *Investment Company Institute v. Camp*, 401 *U.S.* 617, 626-627, 28 *L. Ed.* 2d 367 91 *S. Ct.* 1091 (1971)).

In *Chevron*, the United States Supreme Court developed a two-part test for determining whether deference to an agency interpretation of a statute is appropriate. First, the statute that the agency purports to interpret must be unclear. 467 *U.S.* at 842-43, 104 *S. Ct.* at 2781-82, 81 *L. Ed.* 2d at 703. When Congress has not defined an important statutory term, courts fairly can presume that Congress intended the agency to provide a definition. *Id.* at 843-44, 104 *S. Ct.* at 2782, 81 *L. Ed.* 2d at 703; *see also* Davis & Pierce, *supra*, at § 3.3 (discussing *Chevron* and presumption of congressional delegation); Scalia, *supra*, at 516-17 (same).

In 1864, Congress may not have contemplated specifically that banks would issue credit cards or even that interest would include late fees. Even so, I believe that Congress intended to delegate to the OCC the authority to implement the goals of the NBA. Also likely, Congress intended that in meeting those goals the OCC would adapt to the changing needs of banks and their customers. That adaptation foreseeably includes administrative changes in the definition of "interest." In brief, I believe that federal banking regulators are in a better

position than state courts to define the meaning of "interest" in the NBA. That conclusion, in my opinion, also represents sound public policy. On a matter so essential to the national economy as the meaning of "interest" in federal banking legislation, the nation is better served by judicial deference to the judgment of Congress and the banking regulators.

The second part of the *Chevron* test directs courts to defer to reasonable agency interpretations. 467 *U.S.* at 844-45, 104 *S. Ct.* at 2782-83, 81 *L. Ed.* 2d at 704; *see also* Davis & Pierce, *supra,* at § 3.3; Scalia, *supra* at 516-18. Implicit in the notion of reasonableness is discretion in choosing among alternatives. In defining "interest" to include late charges, the OCC has made a reasonable choice among possible definitions of interest. Of course, if Congress should disagree with the agency's interpretation, it retains the authority to redefine the term. *See, e.g., CFTC v. Schor,* 478 *U.S.* 833, 845-46, 106 *S. Ct.* 3245, 3254, 92 *L. Ed.* 2d 675, 689 (1986) (suggesting that Congress's failure to overrule agency supports conclusion that agency definition comports with congressional intent).

The OCC consistently has determined that late-payment and certain other non-periodic fees are interest for purposes of section 85 of the NBA. In a recent interpretive letter, the agency concluded that a federal definition of "interest" under section 85 includes late fees. Letter by Julie L. Williams, Chief Counsel (Feb. 17, 1995), 1995 *WL* 419824 (O.C.C.). Earlier letters, although relying on the law of the national bank's home state, reached the same conclusion. *See* Letter by William P. Bowden, Jr., Chief Counsel (Feb. 4, 1992), 1992 *WL* 136390 (O.C.C.) at *9-*11 (concluding that state law determines fees material to

definition of interest) (the Bowden Letter); Letter by Robert B. Serino, Deputy Chief Counsel, Office of the Comptroller of Currency [1988-89 Transfer Binder] *Fed. Banking L. Rep.* (CCH) ¶ 85,676 at 78,063 (Aug. 11, 1988) (same) (the Serino Letter); Letter by Charles F. Byrd, Assistant Director, Legal Advisory Services (May 5, 1986), 1986 *WL* 143937 (O.C.C.) at *3 (concluding that state law determines maximum interest rate). *But see* Letter from Peter Liebesman, Assistant Director, Bank Operations and Assets Division (Feb. 26, 1993), 1993 *WL* 501557 (O.C.C.) at *9 (suggesting in *dicta* that late fees are not material to definition of interest absent state law conclusion to contrary). In sum, the OCC consistently has concluded that if a state allows any lender to charge interest in the form of late-payment fees, a national bank located in that state may charge those fees to its out-of-state borrowers.

To confirm that interest, for purposes of the NBA, includes late fees, the OCC recently promulgated proposed Interpretive Ruling § 7.4001 for inclusion in the Code of Federal Regulations. 60 *Fed. Reg.* 11924, 11940 (1995) (to be codified at 12 *C.F.R.* 7.4001) (proposed March 3, 1995). The proposed ruling states:

> The word "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for any extension of credit, the making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, . . . numerical periodic rates, late fees, not sufficient funds fees, overlimit fees, annual fees, cash advance fees, and membership fees.

If adopted, the proposed ruling would further evidence the OCC's conviction that late fees are interest. The majority's cavalier dismissal of the proposed ruling, *ante* at ___ (slip op. at 22), fails to consider the ruling's significance.

The agency's definition of "interest," as expressed in its interpretive letters, is clear. The judicial task is to determine whether that interpretation is reasonable. *Nationsbank, supra,* 513 *U.S.* at ___, 115 *S. Ct.* at 813, 130 *L. Ed.* 2d at 748; *Chevron, supra,* 467 *U.S.* at 843-44, 104 *S. Ct.* at 2782-83, 81 *L. Ed.* 2d at 704. In its February 17, 1995, interpretive letter, *supra,* the OCC documented early federal case law that defined "interest" as the "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown, supra,* 82 *U.S.* (15 *Wall.*) at 185, 21 *L. Ed.* at 131. The letter then concludes that late-payment fees, which legitimately compensate lenders for increased lending costs and risks associated with delinquent borrowers, are interest.

The OCC's conclusion is reasonable. It permits a national bank to charge any fees related to the use of money, if those charges are authorized by the bank's home state. That concept of parity comports with the NBA's goal of preventing discrimination against national banks. No principled reason confines the NBA to periodic interest rates.

Contrary to the protestations of the majority, *ante* at ___ (slip op. at 22-26), the evolution of the OCC's analysis does not render its opinion unworthy of judicial deference. *Chevron* counsels that an agency's change in a policy

determination is not necessarily entitled to less respect because of the change. *See* 467 *U.S.* at 863-64, 104 *S. Ct.* at 2792, 81 *L. Ed.* 2d at 715-16; Scalia, *supra,* at 517-19 (discussing *Chevron's* rejection of consistency requirement); Starr, *supra,* at 297-98 (same). Although the agency's analysis may have evolved over time, the analytical path has consistently led to the conclusion that national banks may export late fees. Late charges, moreover, are sufficiently close to the essence of "interest" to justify the OCC's decision to include them within the meaning of the word. The prototypical definition of "interest" as periodic interest is broad enough to encompass late charges. *See generally* Lawrence M. Solan, *Judicial Decisions and Linguistic Analysis: Is There a Linguist in the Court?*, 73 *Wash. U. L.Q.* 1069 (1995) (discussing definitional and prototypical interpretations of statutory language). I accept the conclusion of the banking regulators that interest for purposes of the NBA may include late charges and other fees charged by lenders in connection with a loan.

-IV-

-A-

Having determined that section 85's definition of "interest" includes late fees, the next question is whether that definition preempts the RISA's prohibition against the imposition of such fees. More specifically, the question is whether Congress intended that the NBA, as interpreted by the OCC, should preempt state law.

Congress may preempt a state law by expressly stating that it so intends, *e.g., Cipollone v. Liggett Group, Inc.,* 505 *U.S.* 504, ___, 112 *S. Ct.* 2608, 2617, 120 *L. Ed.* 2d 407,

422-23 (1992); by occupying an entire field of regulation, *e.g.*, *Rice v. Santa Fe Elevator Corp.*, 331 *U.S.* 218, 230, 67 *S. Ct.* 1146, 1152, 91 *L. Ed.* 1447, 1459 (1947); or by enacting a federal statute that conflicts with a state law, *Hillsborough County, supra*, 471 *U.S.* at 713, 105 *S. Ct.* at 2375, 85 *L. Ed.* 2d at 721; *Maryland v. Louisiana*, 451 *U.S.* 725, 747, 101 *S. Ct.* 2114, 2129, 68 *L. Ed.* 2d 576, 596 (1981).

Section 85 does not contain an express preemption clause. Given the dual regulation of banking by state and federal regulators, Congress may not have occupied completely the field of banking regulation. The question becomes whether section 85's definition of "interest," which permits national banks to impose late fees, conflicts with the RISA's prohibition of such fees.

My analysis begins with the Supremacy Clause of the United States Constitution:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.
>
> [*U.S. Const., art.* VI, *cl.* 2.]

Ever since *Gibbons v. Ogden*, the Supremacy Clause has mandated preemption of state laws that "interfere with, or are contrary to the laws of Congress. . . . " 22 *U.S.* (9 Wheat.) 1, 6 *L. Ed.* 23 (1824). Notwithstanding the supremacy of federal law, the United States Supreme Court has "never assumed lightly that Congress has derogated state regulation, but instead [has] addressed claims

of pre-emption with the starting presumption that Congress does not intend to supplant state law." *New York Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 *U.S.* ___, ___, 115 *S. Ct.* 1671, 1676, 131 *L. Ed.* 2d 695, 704 (1995); *see Maryland, supra*, 451 *U.S.* at 747, 101 *S. Ct.* at 2129, 68 *L. Ed.* 2d at 595; *Rice, supra*, 331 *U.S.* at 230, 67 *S. Ct.* at 1152, 91 *L. Ed.* at 1459. The Court, however, has found conflict to be preemptive when "compliance with both federal and state [laws] is a physical impossibility." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 *U.S.* 132, 142-43, 83 *S. Ct.* 1210, 1217-18, 10 *L. Ed.* 2d 248, 257 (1963). It likewise has recognized preemption of state law when that law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 *U.S.* 52, 67, 61 *S. Ct.* 399, 404, 85 *L. Ed.* 581, 587 (1941). Preemption is not foreclosed, however, merely because a federal statute displaces a traditional subject of state regulation. *See Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta*, 458 *U.S.* 141, 153, 102 *S. Ct.* 3014, 3022, 73 *L. Ed.* 2d 664, 675 (1982); *Greenwood Trust, supra*, 971 *F.* 2d at 828. To constrict unduly a federal statute to avoid interference with a state law would subvert the Supremacy Clause.

Against that background, the question recurs whether section 85, which permits a national bank to impose a late fee, and the RISA, which prohibits such a fee, are in conflict. In one sense, to state the question is to answer it. When state law prohibits an act that federal law permits, the conflict is apparent. True, section 85 does not mandate that national banks must charge late fees. The problem arises only when the national bank seeks to impose a late fee. By foregoing late fees, Citibank could

avoid the conflict. That analysis, however, begs the question.

As with ascertaining the meaning of "interest," I find guidance on the question of preemption in the rulings of the OCC. In her February 17, 1995, letter, *supra*, OCC Chief Counsel Julie Williams ruled:

> [W]e reaffirm our previous conclusion that "interest" permitted under section 85 may be charged without reference to whether all or part of it is permissible under the laws of the state where the customer resides. If the law of the state where the customer resides is different from the law of the state in which the bank is located, the former law has no effect on what the bank may charge as "interest."

Accord the Bowden Letter, *supra;* the Serino Letter, *supra; see also* Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep.* (CCH) ¶ 81,534 at 55,730-31 (July 8, 1992) (reaching same conclusion under section 521); Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 93-27, *Fed. Banking L. Rep.* (CCH) ¶ 81,635 at 55,838-39 (July 12, 1993) (same).

Admittedly, an agency statement according a preemptive effect to a statute is not as persuasive as an express statutory clause. Given the pervasive role that Congress has entrusted to federal banking regulators, however, I would respect consistent regulatory rulings on preemption. *City of New York v. FCC*, 486 *U.S.* 57, 64, 108 *S. Ct.* 1637, 1642, 100 *L. Ed.* 2d 48, 57 (1988) ("[I]f the agency's choice to pre-empt 'represents a reasonable accommodation of conflicting policies that were committed to the agency's care . . . , we should not disturb it

unless it appears . . . that the accommodation is not one that Congress would have sanctioned.' ") (quoting *U.S. v. Shimer*, 367 *U.S.* 374, 383, 81 *S. Ct.* 1554, 1560, 6 *L. Ed.* 2d 908, 915 (1961)).

Federal supremacy in the regulation of credit-card interest charges also makes sense. In many respects, credit cards have replaced the national currency. Residents of one state regularly make credit-card purchases from mail-order retailers in other states. Similarly, they use credit cards to charge meals, lodging, transportation, and other expenses when traveling throughout the nation and the world. Credit cardholders, moreover, can change their state of residence. Given the mobility of credit cardholders and transactions, federal regulation incorporating a bank's home-state's law is reasonable. The majority recognizes as much. It writes: "The theory of the NBA, as applied by federal and state courts, is that the borrower's state usury laws can be discarded because the customer either taking out a loan or using her 'lender credit card' partakes in a transaction in the national lender's home state." *Ante* at ___ (slip op. at 37).

-B-

Close analysis of New Jersey law, moreover, reveals that the RISA impermissibly interferes with the congressional goal of preventing states from discriminating against national banks. *Tiffany, supra*, 85 *U.S.* at 412-13, 21 *L. Ed.* at 863-64. Although the RISA prohibits certain lenders from imposing late fees on delinquent borrowers, various statutory provisions expressly authorize other lenders to charge such fees. For example, *N.J.S.A.*

17:13-104b expressly authorizes credit unions to charge late fees: "A credit union may charge late fees . . . not to exceed 20% of the principal balance and interest outstanding. . . . " Similarly, *N.J.S.A.* 17:16C-42(b), *L.* 1995, *c.* 43, § 1, as recently amended, provides that "[t]he holder of any retail charge account may collect a delinquency or collection charge in an amount not to exceed $10. . . . " Moreover, *N.J.S.A.* 17:9A-59.7 authorizes banks to charge late fees on advance loans. Thus, some New Jersey lenders are authorized expressly to charge late fees.

In 1981, the New Jersey Legislature enacted the State Bank Parity Act (the Parity Act), *N.J.S.A.* 17:13B-1 to -2, which is modelled after section 85. The Parity Act provides: "Notwithstanding any . . . statute to the contrary, any bank, savings bank, savings and loan association or credit union may charge a rate of interest . . . permitted to any other lender by the laws of this State. . . . " *N.J.S.A.* 17:13B-2.

If late fees are interest under the Parity Act, then any New Jersey bank may charge them. On that premise, the RISA would prohibit only national and out-of-state banks, such as Citibank, from charging late fees. That result would discriminate against out-of-state national banks that lend money to New Jersey borrowers. A state law that discriminates against out-of-state national banks conflicts directly with Congress's goals, and, therefore, is preempted.

The possibility of that conflict raises the question whether late fees are "interest" for purposes of the Parity Act. Title 17, which governs financial institutions, does not expressly define the term. The relevant New Jersey

statutes send inconsistent signals on the question whether the definition of interest excludes late fees. For example, *N.J.S.A.* 17:13-104(b), the same provision that authorizes credit unions to charge late fees, also authorizes credit unions to charge interest. Similarly, holders of retail charge accounts may charge interest under *N.J.S.A.* 17:16C-40 and late fees under *N.J.S.A.* 17:16C-42. Furthermore, *N.J.S.A.* 17:9A-59.6 discusses interest rates on advance loans, and *N.J.S.A.* 17:9A-59.7 authorizes late fees on those loans.

Although New Jersey statutes apparently distinguish annual interest and late fees, I cannot ignore the Legislature's unequivocal statement that it enacted the Parity Act as a corollary to section 85. The Assembly Banking and Insurance Committee Statement that accompanied the Parity Act declared that the Act

> would give state chartered banks, savings banks, savings and loan associations, and credit unions the same "most-favored-lender" authority that national banks presently enjoy. By the provision of 12 *U.S.C.* 85, national banks may take interest at the rate allowed by the laws of any state. . . . The [OCC], who supervises national banks, has interpreted this to mean that national banks may charge interest not only at the rate permitted by state law to banking institutions, but also at the rate for a similar type of loan made by any licensed lender. . . . This legislation, therefore, provides [similar] parity to state-chartered institutions.

In the Parity Act, the Legislature intended to grant state banking institutions the same benefits that national banks enjoy under the NBA, as construed by the OCC. Under

the Parity Act, therefore, state banks, like national banks, may charge late fees as interest.

The New Jersey Department of Banking has concluded that because late fees are interest under the NBA, they are interest for the purposes of the Parity Act. *See* Letter from Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994). Although informally expressed, the assistant commissioner's letter is the department's only expression of its understanding of the meaning of interest in the Parity Act. Both the state and federal legislative schemes rely on regulation by administrative agencies. Because the Legislature has entrusted the department with the regulation of state banks, the department's interpretations of state banking laws are entitled to judicial deference. *Lammers, supra,* 134 *N.J.* at 274.

Admittedly, the Legislature has not drawn distinct lines; it could have expressed its intent more definitively. We are remitted to finding the Legislature's intent in a statutory mosaic. The majority sees one picture. I see another.

I conclude that the definition of interest in the Parity Act includes late fees. Under the Parity Act, because credit unions and retailers may charge late fees, "any bank, savings bank, [or] savings and loan association" chartered in New Jersey also may charge such fees.

Because state-chartered banks may charge late fees to New Jersey customers, a state law, such as the RISA, that prohibits out-of-state national banks from charging such fees would constitute impermissible discrimination in violation of the Supremacy Clause. In sum, I would hold that the NBA conflicts with, and thus preempts, the RISA.

-V-

Interestingly, the majority concludes that in the future out-of-state national banks may impose limited late-payment fees on New Jersey cardholders. The Court so concludes because the 1995 amendment to *N.J.S.A.* 17:16C-42,*L.* 1995, *c.* 43, § 1, extends the right to charge late fees of up to $10 to holders of retail charge accounts. For me, however, the source of a national bank's authority to impose late fees is not the RISA, but the NBA. By declaring that the RISA determines the amount of the late fee that a national bank may charge, the majority has inverted the Supremacy Clause so that state law trumps federal law. The need for uniform regulation of national banks, not misplaced notions of federalism, should prevail.

Ultimately dividing the majority and dissent are differing perceptions of the roles of Congress, federal banking regulators, and state courts in regulating national banks. The majority takes a position reminiscent of states'-rights advocates who opposed federal regulation of interstate commerce and of national banks. Banking, however, is integral to the national economy. Credit cards and other innovations such as electronic money transfers have converted consumer lending from a local to a national activity. In that context, the need for federal control is paramount. Until such time as Congress explicitly determines whether interest includes late charges, I would defer to the judgment of the OCC.

My colleague, Justice O'Hern, reaches the same result as do I, but through a different analysis. He proceeds from the major premise that the NBA expresses a general congressional intent, apart from the terms of the statute, that states must not favor state banks over national banks. *Post* at ___ (slip op. at 1). His minor premise is that New Jersey law permits lenders to impose late charges as interest. *Id.* at ___ (slip op. at 4). From this, he concludes that by permitting New Jersey banks, but not national banks, to impose such charges, New Jersey law violates the NBA.

My problem with his analysis is with its divination of congressional intent apart from the terms of the statute. For me, the reason that the NBA trumps RISA is that section 85 expressly permits national banks to charge "interest at the rate allowed by the laws of the State . . . where the bank is located." "Interest," as previously explained, includes late charges. Close examination of the authorities cited by Justice O'Hern reveals that they rely not on metaphysical notions of congressional intent, but on the specific words of the statute. *Post* at ___ (slip op. at 3-4). I also find misplaced his concern that Congress did not intend states to "export" their "consumer protection attitudes" to other states. *Id.* at ___ (slip op. at 7).

The mischief hides in the term "export." When a South Dakota national bank charges interest, including late fees, as allowed by that state to a borrower in New Jersey, the charge is legal because the NBA expressly allows it, not because South Dakota is "exporting" its interest rate to New Jersey. The authority for the imposition of the charge is not South Dakota law, but the NBA.

Congress has defined the standard to measure the allowable rate of interest; that standard is interest as allowed by the national bank's home state. As Citibank's home state, South Dakota merely provides the point of reference. Only in a metaphorical sense is South Dakota "exporting" its rate of interest. In reality, a national bank may impose interest as allowed by its home state because Congress has so ordained.

For the preceding reasons, I respectfully dissent.

Justice Garibaldi joins in this dissent.

SUPREME COURT OF NEW JERSEY
A-102 September Term 1994

MARC SHERMAN, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant-Respondent.

O'HERN, J., dissenting.

I agree with the majority that the National Bank Act does not preempt state consumer protection laws that prohibit late charges on credit card accounts. I would, however, allow national banks to assess late charges against credit card holders in New Jersey, not because the late charges are interest under the National Bank Act (they are not) and not because Congress has authorized the Comptroller of the Currency to preempt the State's consumer protection law, but because New Jersey law permits lenders to impose such late charges and may not discriminate against national banks that seek to impose the same charges.

In 1864 Congress enacted the National Bank Act, *c.* 106, 13 *Stat.* 99 (NBA). Section 85 of the NBA now provides that any national bank

> may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State * * *

> where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater * * * .

[12 *U.S.C.A.* § 85.]

In addition to addressing interest rate differentials between state and national lending institutions, the NBA had a more profound purpose and effect – to assure that national banking institutions were never put at any economic disadvantage in competition with state-chartered institutions.[1]

Before the Civil War, Jacksonian distrust of concentrated power of mercantile interests had brought about the demise of national banks and the rise of the state banking systems. *Clarke v. Securities Indus. Ass'n*, 479 *U.S.* 388, 413, n.5, 107 *S. Ct.* 750, 764, n.5, 93 *L. Ed.* 2d 757, 777, n.5 (1987) (Stevens, J., concurring).

> Enactment of the National Bank Act was part of Congress's attempt to induce state-chartered banks to convert to national charters in order to achieve several federal objectives, such as the development of a national currency, the creation of a market for federal bonds to finance

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[1] Sections 521 through 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980, *Pub. L.* No. 96221, 94 *Stat.* 132, authorize other federally insured depository institutions to collect interest as allowed by the laws of the state in which they are located. Those provisions generally confer on federally insured state banks the privileges that national banks enjoy under the NBA. For convenience of analysis, I refer only to the federally chartered institutions.

> the war, and the use of the national banks as depositories.
>
> [Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 *Geo. Wash. L. Rev.* 676, 699 (1983).]

If state-chartered banking institutions were permitted to make loans on more favorable terms than nationally chartered institutions, then nationally chartered institutions would be at an economic disadvantage. Congress "deliberately settled upon a policy intended to foster 'competitive equality' " between national banks and state banks. *First Nat'l Bank in Plant City, Fla. v. Dickinson*, 396 *U.S.* 122, 131, 90 *S. Ct.* 337, 342, 24 L. Ed. 2d 312, 318 (1969) (quoting *First Nat'l Bank of Loan, Utah v. Walker Bank & Trust Co.*, 385 *U.S.* 252, 261, 87 *S. Ct.* 492, 497, 17 *L. Ed.* 2d 343, 349 (1966)). In the *Walker Bank* case, involving branch banking issues, the Court wrote: "To us it appears beyond question that the Congress was continuing its *policy of equalization* first adopted in the National Bank Act of 1864." 385 *U.S.* at 261, 87 *S. Ct.* at 497, 17 *L. Ed.* 2d at 349 (emphasis added).

Because equalization, not preemption, is the congressional policy, New Jersey cannot grant late-charge privileges to its financial institutions and not to national banks:

> The purpose of section 85 is [1] to adopt the state law, relating to interest rates permitted, to permit national banks to charge the rate of interest allowed to competing lenders in the state, *and* [2] to guard against unfriendly federal-state legislation or ruinous competition with state chartered or licensed lenders. This interpretation of Section 85, commonly referred to as "the most favored lender policy" puts national banks on an equal footing with the most favored lenders in the state without giving them an unconscionable and destructive advantage over all state lenders. The statute prevents state legislation which purports to give state banks or possibly any state lender advantages over national banks.
>
> [*United Missouri Bank of Kansas City, N.A. v. Danforth*, 394 *F. Supp.* 774, 779 (W.D. Mo. 1975) (emphasis added).]

The New Jersey Department of Banking reasons that state-chartered credit unions "are authorized to offer credit cards and charge late charges without limit." (Letter from Francis P. Carr, Assistant Commissioner, New Jersey Department of Banking, to Dennis R. Casale 1 (Oct. 14, 1994) (citing *N.J.S.A.* 17:13-105(c)). Thus, even though late charges are not interest, a national bank must be permitted to impose late charges as long as a state lender may impose them. *See Saul v. Midlantic Nat'l Bank/South*, 240 *N.J. Super.* 62, 81 (App. Div.) (recognizing that under "most favored lender" doctrine, national banks may make loans on same terms as state-chartered credit union), *certif. denied*, 122 *N.J.* 319 (1990).

In addition, *S.* 1412, signed into law on March 7, 1995, amended the Retail Installment Sales Act (RISA), *N.J.S.A.* 17:16C-1 to -61, the statute on which plaintiffs have based their claims in this case. The 1995 amendment expressly authorizes the holder of any retail charge account to collect flat late charges. *N.J.S.A.* 17:16C-42. After that amendment there can be no question that a

nationally chartered credit card lender may not impose such late charges, at least to the extent allowed under S. 1412. Were it otherwise, Citibank explains, there would be favoritism shown to state lenders:

> The favored lender, by contracting for flat, contingent charges from late payers, can protect itself against risks and costs associated with delinquencies while keeping monthly percentage charges low to attract good customers who are consistently punctual. The disfavored lender, who cannot collect late charges, tends to get all the customers who anticipate paying late and tends to lose the customers with strong credit and habits of punctuality because it must impose higher monthly percentage charges to make up for its inability to impose late charges.

That competitive advantage cannot be given to the state-chartered institutions. *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 *F.*2d 855, 863 (6th Cir. 1972), held that because a Michigan-chartered savings and loan association was permitted to charge a borrower (in addition to interest) the closing costs of a real estate loan, a national bank could legally impose such additional charges. The *Northway Lanes* court quoted a principal drafter of the NBA, Senator John Sherman of Ohio, who explained that the purpose of the NBA was "to confer on these national banks the same privileges that are conferred by the laws of the States on other associations and individuals * * * [and] to place the national banks in each state on precisely the same footing with individuals and persons doing business in the state by its laws." 464 *F.*2d at 861 (quoting *Cong. Globe*, 38th Cong. 1st Sess. 2126 (1863)).

"National banks have been national favorites." *Tiffany v. National Bank of Missouri*, 85 *U.S.* (18 Wall.) 409, 413, 21 *L. Ed.* 862, 864 (1874). The NBA confers on them *"at least competitive equality"* with other lenders and a "possible advantage over state banks in the field of interest rates." *Fisher v. First Nat'l Bank of Omaha*, 548 *F.*2d 255, 259 (8th Cir. 1977) (emphasis added). No state may create a competitive disadvantage by favoring any class of state lenders over national lenders, as New Jersey would favor its state lenders if they alone can impose late charges. An Opinion Letter from the Office of the Comptroller of the Currency explains:

> [I]f a state allows state banks to charge credit card annual fees at flat rates, then section 85 allows national banks to do so as well. If national banks were not allowed to match state-regulated lenders on these flat loan charges, then the "most favored lender" principle would be destroyed.
>
> [Letter from Julie L. Williams, Chief Counsel, to John L. Douglas (Feb. 17, 1995), 1995 *WL* 71676 (OCC), *6.]

Plaintiffs seek to avoid the application of the "most favored lender" doctrine by arguing that The Credit Union Act, *N.J.S.A.* 17:13-73.1 to -125, did not always authorize unlimited late fees on retail charge cards, insisting that the more specific provisions of RISA controlled retail credit card transactions. Plaintiffs' interpretation of the law is of little consequence as long as the State regulators continue to permit state-chartered lenders to impose late charges. The NBA forbids precisely that form of discrimination against national banks.

States have a profound interest in their consumer protection laws. *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 *U.S.* 299, 314, 99 *S. Ct.* 540, 548, 58 *L. Ed.* 2d 534, 545-46 (1978), held only that "interest rates of one State [can be] 'exported' into another" because a literal application of the plain language of "rate allowed" in Section 85 compelled that result. Only a distorted reading of Section 85 would allow exportation of the consumer protection attitudes of the home state of the national bank. See William G. Bornstein, Comment, *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View*, 27 *Vill. L. Rev.* 1077, 1107-08 (1981-82) (analyzing the *Marquette* holding).

I cannot imagine that Congress intended that South Dakota or Delaware be permitted to export their concepts of consumer protection and to preempt and nullify the consumer protection laws of New Jersey. I therefore agree with that portion of the Court's opinion.

(3)

No. 95-860

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On Petition for a Writ of Certiorari to the California Supreme Court

RESPONDENT'S MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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20 pp

QUESTION PRESENTED

The sole question properly presented for review is the third question listed in the petition, which respondent would suggest rephrasing as follows:

> Does the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, include late payment fees that are charged by a national bank on credit card accounts?

Petitioner's first two questions are not presented in this case: the California Supreme Court did not hold, and no party contends, that the South Dakota legislature has the power to define the term "interest" as used in section 85 of the National Bank Act. *See* discussion *infra* pp. 7-8.

RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, respondent Citibank (South Dakota), N.A. states that it is a wholly owned subsidiary of Citicorp Holdings, Inc., which is a wholly owned subsidiary of Citicorp. Citibank (South Dakota), N.A. has two wholly owned subsidiaries: CDC Holdings Inc. ("CDC Holdings") and CitiHousing, Inc. Citicorp Diners Club Inc. ("Diners Club") is a wholly owned subsidiary of CDC Holdings, and Diners' Colorado Realty Corp. is a wholly owned subsidiary of Diners Club.

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OPINIONS BELOW

The opinion of the California Supreme Court is reported as *Smiley v. Citibank (South Dakota), N.A.*, 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995) (Pet. App. 1-72). The depublished opinion of the Court of Appeal appears at *Smiley v. Citibank (South Dakota), N.A.*, 26 Cal. App. 4th 1767, 1770, 32 Cal. Rptr. 2d 562, 564, *review granted*, 35 Cal. Rptr. 2d 269 (Cal. 1994) (Pet. App. 74-98). The order and opinion of the trial court are not reported.

JURISDICTION

The California Supreme Court entered its judgment on September 1, 1995. The petition was filed and docketed on November 30, 1995. The jurisdiction of this Court is invoked under section 1257(a) of title 28.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause, U.S. Const. art. VI, cl. 2, is set out at pages 1-2 of the petition.

Section 85 of the National Bank Act, 12 U.S.C. § 85, is set out, in relevant part, at page 2 of the petition.

Section 86 of the National Bank Act, 12 U.S.C. § 86, is set out, in relevant part, at page 2 of the petition.

Section 54-3-1 of the South Dakota Codified Laws states as follows:

> Interest is the compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation, points, loan origination fees, credit service or carrying charges, charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit. These charges do not include charges made by a third party.

S.D. Codified Laws Ann. § 54-3-1 (1990).

Section 54-1-1.1 of the South Dakota Codified Laws states, in relevant part, that:

> Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement.

S.D. Codified Laws Ann. § 54-1-1.1 (1990).

The California Civil Code provision that governs liquidated damages, Cal. Civ. Code § 1671, is set out at page 3 of the petition.

STATEMENT

A. INTRODUCTION

Respondent Citibank (South Dakota), N.A. ("Citibank") agrees with petitioner that the Court should grant a writ of certiorari to resolve a direct conflict between the highest courts of different states on an important question of federal law: whether the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, includes late payment fees. The decision of the California Supreme Court (Mosk, J.) from which petitioner seeks review is consistent with recent decisions of the Colorado Supreme Court, *see Copeland v. MBNA America Bank, N.A.*, No. 94SC409, 1995 WL 696449 (Colo. Nov. 20, 1995), and the United States Court of Appeals for the First Circuit, *see Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993). Those decisions are also in harmony with the interpretation of section 85 on this point by the Office of the Comptroller of the Currency (the "OCC"), which charters and supervises national banks, including Citibank. A subsequent decision by the New Jersey Supreme Court, however, directly conflicts with this authority. *See Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94 (N.J. Nov. 28, 1995)(Pet. App. 151-224).

The question of federal law on which the California and New Jersey Supreme Courts disagree is very important. National banks lend hundreds of billions of dollars every

year on terms set in reliance on the authority conferred by section 85 to assess charges for the use or detention of their money. The national banks have relied on the established interpretation of that statute adopted by the California Supreme Court as well as the OCC. Uncertainty about the meaning of section 85 would "throw into confusion the complex system of modern interstate banking." *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 312 (1978). Moreover, very large amounts are at stake in the present case and other litigations pending around the country. Citibank therefore supports the petition insofar as it asks the Court to review the question stated above. In plenary briefing, Citibank will request that the Court affirm in its entirety the decision of the California Supreme Court.

B. BACKGROUND

Citibank is a national banking association chartered by the OCC, a unit of the Treasury Department. Citibank's only location is in Sioux Falls, South Dakota. From that location, Citibank issues Visa, Mastercard, and other credit cards to customers nationwide, extends credit pursuant to the agreements covering such cards, and collects the charges that cardholders have contracted to pay. (*See* Pet. App. 2). Citibank's credit card agreements generally provide for both "finance charges" on certain outstanding balances and "late payment charges" if a cardholder does not make a required minimum payment by a specified date. (*Id.*) The late payment charges are imposed in the form of both a flat fee and, in some instances, as a percentage of the borrower's account balance. (Pet. App. 40 n.17).

On July 7, 1992, petitioner filed her complaint as a purported class action in the Los Angeles Superior Court challenging Citibank's late payment charges. She alleged that she is a California resident and that Citibank had assessed late payment charges on her MasterCard and

Preferred Visa credit card accounts. (Pet. App. 109-10, 114-18). Such charges were consistent with the express terms of her card agreements with Citibank and are permitted under the law of South Dakota, Citibank's home state. Petitioner alleged, however, that such fees are impermissible under California law. (Pet. App. 114-18).

On August 5, 1992, Citibank removed the action, on grounds of the parties' diversity of citizenship, to the United States District Court for the Central District of California. On January 14, 1993, the District Court granted petitioner's motion to remand the matter to state court on the ground of lack of diversity.

C. HOW THE FEDERAL QUESTION WAS PRESENTED AND RESOLVED BELOW

Petitioner's claim was predicated entirely on her contention that late payment charges assessed by Citibank on credit card accounts of California residents violate section 1671 of the California Civil Code. On April 28, 1993, Citibank moved the Superior Court for a judgment on the pleadings dismissing all claims set forth in the Complaint. The basis for Citibank's motion was that, under section 85 of the National Bank Act, Citibank is authorized to charge the "interest" allowed to state-regulated lenders by its home state; that the term "interest" as used in section 85 includes credit card late payment charges; and that, as this Court held in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978), section 85 preempts any conflicting state law.

On July 6, 1993, the Superior Court denied Citibank's motion. On August 23, 1993, Citibank filed in the California Court of Appeal a Petition for Writ of Mandate. The Court of Appeal issued an alternative writ (commanding the trial court to grant Citibank's motion or, alternatively, to show cause why its decision should not be reversed) on

September 7, 1993. On September 14, 1993, the Superior Court entered a minute order granting Citibank's motion, and on October 6, 1993, the Superior Court entered an Order setting forth its findings and conclusions. (Pet. App. 8 n.2 & 99-105). On July 11, 1994, the Court of Appeal issued its opinion affirming the Superior Court's decision. (Pet. App. 74-98). On October 27, 1994, the California Supreme Court granted review, and on September 1, 1995, the California Supreme Court affirmed the judgment of the Court of Appeal. (Pet. App. 1-72).

The California Supreme Court began its analysis by recognizing that "[t]he issue is not the existence of preemption under section 85," because this Court held unanimously in *Marquette* that section 85 prescribes the interest that a national bank may charge on loans to a borrower who resides in another state and overrides any contrary law of the borrower's state. (Pet. App. 12-13). Thus, if a charge made by a national bank is "interest" within the meaning of section 85, any contrary law of the borrower's state "must, of course, give way to the federal statute." *Marquette*, 439 U.S. at 318 n.31.

The court then turned to the only issue before it: "the meaning that the term 'interest' bears within" section 85. (*See* Pet. App. 14). After noting that the term "interest" is not expressly defined in section 85, the court looked at the purpose of the Act, which is to ensure that the national bank has the same rights as the "most favored lender" within its home state. (*See* Pet. App. 15 (citing *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 413 (1873)). The court then concluded that the term "interest," as defined before, at, and after the 1864 enactment of the National Bank Act, "could include . . . a late payment fee, payable contingently in the event of default after maturity." (Pet. App. 18-20). Accordingly, the court held that section 85 empowers a national bank to collect such charges if

they are allowed to other lenders located in the bank's home state, and that the law of California is preempted to the extent it is to the contrary. (*See* Pet. App. 38-39).

ARGUMENT

A. THE SOLE QUESTION PRESENTED IS WHETHER "INTEREST," AS USED IN SECTION 85, INCLUDES CREDIT CARD LATE PAYMENT CHARGES.

The sole question properly presented for review in this case is whether "interest," as used in section 85, includes late payment fees on credit card accounts. If, as a matter of federal law, "interest" in section 85 includes such fees, then state law purporting to impose conflicting limits on national bank late payment fees is preempted. *See Marquette*, 399 U.S. at 308 & 318 n.31. This Court should grant the writ in this case to resolve the question, because, *first*, state supreme courts have now reached directly conflicting answers, and, *second*, the question is of great importance to national banks, their customers, and the banking system.

Petitioner has listed two other questions (questions 1 and 2 in the petition) that are not properly presented in this case. Contrary to the assumption in petitioner's first question, the California Supreme Court did not hold that the term "interest" in section 85 includes late payment charges by reasoning that the South Dakota legislature so defined it. Rather, the court expressly held that *federal* law provides the definition of "interest" as the term is used in section 85, and that Congress did not intend that the term "interest" be limited to periodic percentage charges. (Pet. App. 23).

Contrary to petitioner's second question presented and the assertions in her petition, the California Supreme Court did not hold that Congress delegated to South Dakota the power

to define "interest." In fact, the court specifically rejected that argument:

> In part, Smiley asserts that the term "interest" in section 85 may not be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. To do so, she claims, would compel a conclusion that Congress failed to define the word itself, but rather delegated the task to the several states in violation of section 1 of article I of the United States Constitution, which "vests" in it "[a]ll legislative Powers [t]herein granted." That is simply not the case. Congress has made no such delegation. As shown above, it has itself defined the word, impliedly if not expressly, to cover late payment fees, if such fees are allowed by a national bank's home state. True, it has adopted in this regard, as by a choice-of-law provision, the usury law of the national bank's home state as the rule governing all loans by the bank in question, even interstate loans, notwithstanding the law of any other state. It has thereby entrusted the question of the lawfulness of a national bank's late payment fees to its home state and to its home state alone. But it has not thereby made a delegation . . . . Here, we conclude that Congress did not delegate its legislative powers to the several states in section 85, in which it adopted for each national bank the usury law of the state in which such bank is located.

(Pet. App. 30).

B. THE INTERPRETATION OF SECTION 85 BY THE CALIFORNIA SUPREME COURT CONFLICTS WITH A SUBSEQUENT INTERPRETATION OF THAT FEDERAL STATUTE BY THE NEW JERSEY SUPREME COURT.

A principal purpose of this Court's certiorari jurisdiction is to resolve conflicts among state courts of last resort on important issues of federal law. *See* Sup. Ct. R. 10(b). On November 28, 1995, the Supreme Court of New Jersey — the highest court in that state — issued a decision in *Sherman v. Citibank (South Dakota), N.A.*, (Pet. App. 151-224), that directly conflicts with the California Supreme Court's decision. The New Jersey court concluded "that late-payment fees are not 'interest' within the intendment and purposes of [the National Bank Act]." (*See* Pet. App. 154). The New Jersey case involved the same defendant and raised the same issue presented here, and respondent will shortly file a petition for a writ of certiorari seeking review of that decision.

The decision of the New Jersey Supreme Court also conflicts with the decision of the court of last resort in Colorado, *see Copeland v. MBNA America Bank, N.A.*, No. 94SC409, 1995 WL 696449, at *6 (Colo. Nov. 20, 1995) ("We conclude that the NBA's purpose and legislative history compel a finding that late payment fees are a form of 'interest' under section 85 of the National Bank Act."), and with the resolution of a similar federal question by the First Circuit, *see Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993) (holding that both section 85 and section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (codified at 12 U.S.C. § 1831d), the parallel federal statute governing state-chartered banks insured by the FDIC, preempted Massachusetts law prohibiting late charges).

Resolution of the federal issue raised by this case will also resolve or affect numerous cases pending in lower courts throughout the country. Other cases, similar to those referred to above, are pending (or have recently been decided by) federal and state courts in Alabama, California, Colorado, Minnesota, New Jersey, Pennsylvania, and Wisconsin.[1] Plaintiffs in these actions are seeking hundreds of millions of dollars in damages. Thus, this issue is of tremendous consequence in terms of the potential liability of banks throughout the nation.

C. THE PROPER INTERPRETATION OF SECTION 85 IS A QUESTION OF SUBSTANTIAL IMPORTANCE

Section 85 empowers a national bank to charge interest at any rate permitted by its home state to the most-favored state-regulated lender. *See Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 413 (1873); (Pet. App. 15-16). To ensure competitive equality between state and national banks, federal and state courts have traditionally interpreted the term "interest" in section 85 to encompass all charges for the use or forbearance of money, including late charges. (*See* Pet. App. 26-27). The term "interest" as

[1] *See, e.g., Hunter v. Rich's Dep't Store*, No. CV 95-PT-1548-S (N.D. Ala. Aug. 31, 1995); *Harris v. Chase Manhattan Bank, N.A.*, 34 Cal. App. 4th 1563, 35 Cal. Rptr. 2d 733 (1994), *review granted and opinion superseded by* 889 P.2d 540, 38 Cal. Rptr. 2d 346 (Cal. 1995), *review dismissed*, 1995 WL 707413 (Cal. Nov. 2, 1995); *Copeland v. MBNA America Bank, N.A.*, No. 94SC409, 1995 WL 696449 (Colo. Nov. 20, 1995); *Tikkanen v. Citibank (South Dakota), N.A.*, 801 F. Supp. 270 (D. Minn. 1992); *Mazaika v. Bank One Columbus, N.A.*, 653 A.2d 640 (Pa. Super. Ct. 1994), *allocator granted*, 659 A.2d 557 (Pa. May 25, 1995); *In re Consolidated Credit Card Litigation*, 849 F. Supp. 1015 (W.D. Pa. 1994) (appeal pending); *Wisconsin v. Ameritech Corp.*, No. 92 CV 1013 (Wis. Cir. Ct. July 14, 1993).

used in 1864 was (and remains) sufficiently broad to accomplish that congressional purpose. (*See* Pet. App. 18-25).

Moreover, the OCC has repeatedly concluded since 1955 that late fees are governed by section 85 (Pet. App. 27-28) (citing OCC rulings); *see* Office of the Comptroller of the Currency, Interpretative Letter No. 670, Julie L. Williams, Chief Counsel (Feb. 17, 1995), *reprinted in* Fed. Banking L. Rep. ¶ 83,618, 1995 WL 416305. Most recently, the OCC has proposed a formal interpretive rule codifying its definition of the term "interest" in section 85; the pending rule would state explicitly that late payment fees are "interest" within the meaning of section 85. *See* 60 Fed. Reg. 11924-11941 (1995) (to be codified at 12 C.F.R. 7.4001) (proposed March 3, 1995).

National banks, including Citibank, have relied on these long-standing judicial and administrative opinions in structuring their interstate lending programs, including their credit card programs. The conflict between the California and New Jersey interpretations of section 85 makes it impossible for a national bank (and, in particular, Citibank, the defendant in both cases) to determine what law governs the charges it may seek to collect in connection with these loans. The OCC emphasized this concern in its *amicus curiae* brief filed with the California Supreme Court in support of Citibank:

> National banks, such as Defendant/Respondent in this action, have relied on the OCC's interpretation of Section 85 and have structured their lending programs to conform to these longstanding interpretations. Indeed, national banks lend millions of dollars of credit every day in reliance on the lending authority conferred by Section 85 and the laws of their home states. Section 85 provides national banks predictability about their lending operations by setting a uniform standard for determining the charges that may be assessed in

> connection with those activities. This predictability and uniformity is critical to interstate lending. If the permissible charges for a credit card transaction were determined with reference to the home state of the borrower, the flow of interstate lending would be severely undermined.

Brief of Amicus Curiae Comptroller of the Currency in Support of Respondent and Defendant at 2.[2]

National banks lend hundreds of billions of dollars a year in reliance on the lending authority conferred by section 85 and the laws of their home state. Uniformity and predictability in the governing law are critical to interstate lending. National banks simply cannot make loans on such a scale without knowing what law will govern their loan charges.

It is also important that this Court resolve the conflict so that state legislatures can determine their regulatory jurisdiction. Indeed, several states, including California and New Jersey, have recently enacted or amended laws governing credit card late fees against the backdrop of law established by section 85, the judicial interpretations of section 85, and the interpretations of that statute by the OCC. (*See* Pet. App. 7 n.2 (citing Cal. Fin. Code §§ 4000-4001 (Deering

[2] In addition, it is important for national banks to know that they can rely on the guidance of the OCC. The OCC is charged with the administration of the National Bank Act and has broad authority over the chartering, supervision, and regulation of almost every aspect of the affairs of banks organized under the National Bank Act, including the power to determine whether a bank's activity is permissible under the national banking laws. *See Independent Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1168 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980). This Court has frequently held that the OCC's interpretation of the National Bank Act is entitled to judicial deference if that interpretation is based on a permissible construction of the statute. *NationsBank, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 816 (1995); *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-04 (1987).

Supp. 1995)); Pet. App. 176-177 (citing N.J.S.A. 17:16C-42(a))). It is therefore important that the question presented be resolved so that all the participants in interstate lending by national banks — the OCC, the state legislatures, the consumers, and the banks — can determine the applicable law.

Finally, the federal question presented is important because of the amounts at stake. Plaintiffs in the actions already pending are seeking hundreds of millions of dollars in damages. The significant impact on national banks of such claims is an additional reason for granting the writ.

CONCLUSION

For the foregoing reasons, Citibank supports the petition insofar as it requests that the Court issue a writ of certiorari to decide the question stated above.

Dated: December 18, 1995

Respectfully submitted,

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No. 95-860

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA SUPREME COURT

AMICI CURIAE BRIEF OF THE AMERICAN BANKERS ASSOCIATION, MASTERCARD INTERNATIONAL INCORPORATED AND VISA U.S.A. INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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December 20, 1995

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This amici curiae brief is filed in support of Citibank (South Dakota), N.A. by the American Bankers Association (the "ABA"), MasterCard International Incorporated ("MasterCard") and VISA U.S.A. Inc. ("VISA"). The ABA,

MasterCard and VISA (collectively, the "Amici") agree with both Petitioner and Respondent that a writ of certiorari should be granted in *Smiley v. Citibank (South Dakota), N.A.*, 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995) (*"Smiley"*). Petitioner and Respondent each provided written consent to filing this amici curiae brief.

INTEREST OF AMICI

The ABA is the largest national trade association of the commercial banking industry in the United States, representing banks in all fifty states and the District of Columbia that hold approximately ninety percent of the domestic assets of all American commercial banks. VISA and MasterCard are associations of financial institutions that license service marks for use in connection with credit cards, debit cards, automated teller machines and related financial services. As of year-end 1994, VISA and MasterCard had approximately 17,000 and 13,600 depository institution members, respectively, that collectively have issued a credit card to most adults in the United States. *The Nilson Report*, Issue No. 591 (Mar. 1995) at 8.

Amici's members that are national banks are vitally interested in the proper interpretation of 12 U.S.C. § 85 ("Section 85"), which governs the interest that may be charged on loans made by national banks. Amici's members that are state-chartered banks, federally- or state-chartered savings associations, or federally- or state-chartered credit unions, also are particularly interested in the interpretation of Section 85 because most of these federally-insured depository institutions have authority under Sections 521 through 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 132 (1980), to charge the same interest that national banks are authorized to charge under Section 85.

See, e.g., *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 830 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993) (Section 521) (*"Greenwood Trust"*); *Gavey Properties/762 v. First Fin. Sav. & Loan Ass'n*, 845 F.2d 519, 521 (5th Cir. 1988) (Section 522).

The discussion below focuses on the importance of this case for the credit card industry because the *Smiley* case deals with credit card loans. However, Section 85 and Sections 521 through 523 of DIDA are not limited to credit card programs; they apply to all types of retail and commercial loans. *See, e.g.*, *Cades v. H & R Block, Inc.*, 43 F.3d 869 (4th Cir. 1994), *cert. denied*, 115 S. Ct. 2247 (1995) (tax refund anticipation loans). Thus, the principles at issue in this case are critically important for virtually every lending function of the banking industry.

SUMMARY OF ARGUMENT

Certiorari should be granted to resolve an irreconcilable conflict between the California and Colorado Supreme Courts and the United States Court of Appeals for the First Circuit on the one hand, and the New Jersey Supreme Court on the other hand, on the important federal question of whether late fees are interest for purposes of Section 85. Immediate resolution of this issue is urgently needed to reestablish the uniform national rule that the federal government established for the national banking system, but that was not followed by the New Jersey Supreme Court.

Prompt review by this Court is imperative because uncertainty regarding the permissibility of late charges assessed with respect to billions of dollars of credit will adversely affect both the ability of borrowers to obtain credit and the national economy. Resolution of this issue also

significantly affects the extraordinary potential liability of Amici's members that have collected late fees permitted by federal law, but not state law; liability that could affect the continued existence of many of Amici's members.

ARGUMENT

I. CERTIORARI SHOULD BE GRANTED TO RESOLVE A CONFLICT BETWEEN THE CALIFORNIA AND COLORADO SUPREME COURTS AND THE FIRST CIRCUIT, AND THE NEW JERSEY SUPREME COURT.

Review on a writ of certiorari is proper in this case because a state court of last resort has decided a federal question in a way that directly conflicts with the decisions of two other state courts of last resort and a federal Court of Appeals. *See* Sup. Ct. R. 10(b). The California Supreme Court in *Smiley*, and the Colorado Supreme Court in *Copeland v. MBNA America Bank, N.A.*, No. 94SC409, 1995 Colo. LEXIS 743 (Colo. Sup. Ct. Nov. 20, 1995) ("*Copeland*"), each held that late fees charged by a national bank on its credit card loans are interest for purposes of Section 85. *Smiley* and *Copeland* both follow the decision of the United States Court of Appeals for the First Circuit in *Greenwood Trust*. Although *Greenwood Trust* involved Section 521 of DIDA, the First Circuit held that late fees are interest charges under that statute because late fees are interest under Section 85. 971 F.2d at 825.

The *Smiley*, *Copeland* and *Greenwood Trust* decisions persuasively and correctly explain why Section 85 applies to late fees. Nonetheless, the New Jersey Supreme Court held in *Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94, 1995 N.J. LEXIS 1355 (N.J. Sup. Ct. Nov. 28, 1995) ("*Sherman*"), that late fees on credit card loans are not covered by Section 85 because that statute applies only to

periodic percentage rate charges assessed on outstanding loan balances.[1]

The conflict between the decisions of the California and Colorado Supreme Courts and the First Circuit on the one hand, and the New Jersey Supreme Court on the other, creates dangerous uncertainty for national banks and their customers throughout the United States. Without resolution of the conflict by this Court, credit card late fees charged by a national bank to borrowers residing in California or Colorado (as well as states included in the First Circuit) will be covered by Section 85, while the same fees charged by the same national bank to borrowers residing in New Jersey will not. Thus, the scope of federal interest authority under Section 85 will vary depending on the state in which a national bank's borrowers reside. Such a result is directly contrary to this Court's ruling in *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), that Section 85 applies on the basis of the national bank's location and not the borrower's residence.

Not only does the New Jersey Supreme Court's interpretation of Section 85 conflict with decisions from the California and Colorado Supreme Courts and the First Circuit, it also conflicts with the interpretation of the federal agency charged with interpreting and enforcing the National Bank Act. The Office of the Comptroller of the Currency (the "OCC") has stated repeatedly that credit card late fees are covered by Section 85. *See, e.g.*, Letter from Julie Williams, OCC Chief Counsel (Feb. 17, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 90,467 (reaffirming and restating the OCC's long-time position). As part of the OCC's general revisions to its interpretive rules, the OCC has

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[1] The New Jersey Supreme Court also held that late fees are not interest under Section 521 of DIDA in *Hunter v. Greenwood Trust Co.*, No. A-103-94, 1995 N.J. LEXIS 1354 (N.J. Sup. Ct. Nov. 28, 1995).

proposed to codify its position that late fees are "interest." *See* proposed 12 C.F.R. § 7.4001, 42 Fed. Reg. 11,924, 11,940 (Mar. 3, 1995). The OCC made its position clear to the California, Colorado, and New Jersey Supreme Courts in amicus briefs filed in the *Smiley, Copeland,* and *Sherman* cases. Yet the New Jersey Supreme Court specifically refused to grant the OCC's interpretation the deference called for by this Court in *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.,* 115 S. Ct. 810 (1995).

The resolution by this Court of the central and fundamental federal question of whether Section 85 applies to late fees is urgently needed now. There is no dispute that the late fees assessed by national banks in numerous pending lawsuits are permissible if Section 85 applies. A conclusive answer from this Court that late fees are interest thus will resolve those lawsuits, and avoid unnecessary, repetitive, costly, and disruptive additional litigation. Immediate resolution of the conflict on this issue also is essential to enable national banks to know what law applies to the late fees they charge on the billions of dollars of credit now being extended to borrowers, and to ensure that the national banking system functions effectively and efficiently.

II. THE ISSUE OF WHETHER LATE FEES ARE COVERED BY SECTION 85 IS OF FUNDAMENTAL IMPORTANCE.

Financial institutions in the United States regularly extend enormous amounts of credit on credit card accounts. The outstanding balances on VISA and MasterCard credit cards issued in the United States alone exceeded $275 billion at mid-year 1995. *The Nilson Report,* Issue No. 603 (Sept. 1995) at 7. Amici's members which extend the hundreds of billions of dollars of credit must be able to determine whether late fees are included in the federal interest authority

provided by Section 85, since late fees constitute a significant component of credit card pricing. Absent such guidance, banks cannot know whether their lending charges comply with applicable fee limitations. If they guess wrongly, they are exposed to tens, if not hundreds, of millions of dollars of liability for imposing excess fees.

The late fee itself is a very important price component of credit card loans. That fee facilitates the fair and efficient administration of credit card programs; it allows card issuers "to impose default costs on late payers, who are responsible for them, and to avoid shifting [such costs] to timely payers, who are not." *Smiley,* 11 Cal. 4th at 161. In addition, late fees constituted a majority of the estimated $2.1 billion in miscellaneous fees (namely, fees other than periodic finance charges, annual fees and cash advance fees) that were collected by bank card issuers in 1994. *See Card Industry Directory* (Faulkner & Grey 1996) at 18.

This issue already has generated a significant amount of complicated, time-consuming, and expensive litigation. Over forty-five class action lawsuits and state enforcement actions have been filed across the country since November 1991 challenging whether Section 85 (or Sections 521 through 523 of DIDA) applies to late fees on credit card loans. To date, such cases have been filed in Alabama, California, Colorado, Maine, Massachusetts, Minnesota, New Jersey, Pennsylvania, South Carolina, and Wisconsin. In many instances, the plaintiffs' theories of state law violations could result in recoveries of a multiple of the allegedly excessive late fees, or even forfeiture of all charges (including periodic finance charges). Prompt resolution of the scope of Section 85 is thus needed to protect national banks (federal instrumentalities) from potentially ruinous damages under state law.

The current uncertainty also presents a clear risk of substantial disruption to the nation's credit card payment systems, which are critical to the functioning of the nation's economy. At mid-year 1995, there were approximately 343.1 million VISA and MasterCard credit cards issued domestically, which accessed about 252.9 million accounts. *The Nilson Report*, Issue No. 603 (Sept. 1995) at 7. Annualizing data for the first six months of 1995, there will be approximately 5.5 billion transactions on VISA and MasterCard credit cards issued in the United States alone, for an aggregate volume of $490.5 billion. *Id.*

In reliance on existing case law and the OCC's interpretations, Amici's members have established pricing for their credit card accounts based upon the understanding that federal law controls the permissibility of late fees. If the courts do not follow the OCC's guidance on this point, the pricing structures of Amici's members will be at risk, leaving those institutions in a potentially precarious state which could threaten their existence. In addition, new interpretations of the applicable law that governs late fees will force Amici's members to engage in costly and time-consuming changes to existing account pricing strategies and systems for servicing their credit card accounts. The uncertainty and resulting dislocation are likely to impact significantly the availability of credit on bank cards nationwide.

CONCLUSION

For the reasons set forth above, Amici strongly urge the Court to grant the petition for certiorari in this case.

Respectfully submitted,

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No. 95-860

In The

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October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

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BC 59202

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NATURE OF ACTION:
MISC CIVIL COMPLAINT-MONEY INVOLVED
CODE 0601

REPORTER/ERM

REPORTER/ERM Trial Judge:

YEAR	MONTH	DAY	PROCEEDINGS	FILED DOC	FEES
1992	JUL	07	COMPLAINT FILED AND SUMMONS ISSUED		128.00
92	8	5	DEFTS NTC OF FILING OF NTC OF REMOVAL	✓	
9			IN US. DISTRICT COURT		
93	4	28	DEFTS. NOTICE OF MOT OF CITIBANK FOR JUDGT. ON PLEADING. 5-14-93 9:00 D. 30		14.00
93	4	28	MEMORANDUM OF POINTS & AUTHORITIES	✓	

93	4	28	DECLA. OF MICHAEL H. STRUB IN SUPPORT OF MOT	✓	
93	6	22	MO. CONT'D 7/6/93 9C 732		
93	7	6	MOT. OF DEF FOR JUDG. MO. DENIED		
93	7	8	NTC. OF RULING ON MO. JUDGMENT		
93	9	14	AMENDED RULING AFTER WRT. OF MANDATE		
93	9	24	NTC. TO ATTY. IN RE NTC. OF APPEAL		
93	10	1	NTC. OF ELECTION TO PROCEED BY APPENDIX IN LIEU OF CLRK'S TRANSCRIPT.	✓	
93	12	3	REMITTITER [sic] W./ OPINION D-CA ORDER DISMISSING PETITION	✓	
94	7	13	OPINION FROM D.C.A.	✓	

94	9	19	VERIFIED MEMO OF COST	✓	
94	10	7	PLTF MOT TO TAX COSTS (10.28.94 8:30 D-32	✓	14.00
94	10	7	DECLA OF PATRICK J. GRANNAN	✓	

* * *

94	10	7	MEMO PTS AND AUTH	✓	
94	10	7	PROOF OF SERVICE	✓	
94	10	21	OPP. TO PLTFS. MO. TAX		
94	10	28	MO. GRANTED		
95	10	16	REMITTITUR W/OPINION D-CA JUDGT AFF	✓	
95	11	13	VERIFIED MEMO OF COSTS	✓	
96	1	2	MEMO OF COST ON APPEAL	✓	

U.S. District Court
Central District of California (Los Angeles)

CIVIL DOCKET FOR CASE #: 92-CV-4688

Smiley v. Citibank Filed: 8/5/92
Assigned to:
Judge David V. Kenyon Jury demand: Defendant
Referred to: Discovery Elgin Edwards

Demand: $50,000 Nature of Suit: 190
Lead Docket: None Jurisdiction: Diversity
Dkt# in Sup Crt LA is 8C059202

Cause: 28:1441 Petition for Removal – Injunctive/
Declaratory Relief

BARBARA SMILEY, On behalf of Herself & All Others Similarly Situated plaintiff	Patrick J Grannan [COR LD NTC] Greenfield & Chimicles 300 S Grand Avenue Suite 1640 Los Angeles, CA 90071 213-626-6100
v.	
CITIBANK, (South Dakota), N.A. defendant	Richard B Kendall [COR LD NTC] Shearman and Sterling 725 S Figueroa Street Twenty-First Floor Los Angeles, CA 90017 213-239-0300
	William M. Burke Richard B. Kendal Michael H. Strub, Jr. Shearman & Sterling 725 S. Figueroa St., 21st Floor Los Angeles, CA 90017 (213) 239-0300 for dfts CitiBank (South Dakota), N.A.

DATE	NR.		PROCEEDINGS CV92-4688 KN (Ex)
8-5-92	sb	1.	Ntc of Rmvl of actn from Superior Crt County od [sic] Los Angeles w/copy of sms & cmp Case No BC059202 Case may be ref'd to Mag Judge Edwards for discov.
8-6-92	dal	2.	P/S svd Martha A. Evans, Esq., Nicholas E. Chimicles, Esq. Notc of assignment to U.S. Mag Judge on 8-6-92 by mail. dfts
8-12-92	dal	3.	ANSWER to cmp; J/T demanded. dfts CitiBank (South Dakota), N.A.
8-26-92	dal	4.	Notc of mot & mot to remand, rtnbl 10-5-92 at 9:30 a.m. plf
		5.	Memo of PA in suppt fo [sic] mot to Remand Class Actn to State Crt. plf
		6.	Decl of Patrick J. Grannan in suppt of mot to Remand Class actn to State Crt. plf
8-13-92	dal		Placed in File Not Used Stip & Prop ord extg time to resp to cmp for damages & injunctive relief; Decl of Michael H. Strub, Jr., in suppt thereof. plf

9-21-92	dal	7.	Decl of Michael H. Strub, Jr., in suppt of opp of Citibank (South Dakota), N.A., to mot of Barbara Smiley to Remand.
		8.	Decl of Michael H. Strub, Jr., in suppt of mot of Citibank (South Dakota), N.A., requesting leave to amd removal petn.
		9.	Opp of Citibank (South Dakota), N.A., to mot of Barbara Smiley to Remand.
		10.	Appendix of certain authorities cited in opp of Citibank (South Dakota), N.A., to mot of Barbara Smiley to Remand.
		11.	Appendix of certain authorities cited in memo of PA of Citibank (South Dakota), N.A. in suppt of mot requesting leave to amd removal petn.
		12.	Memo of PA of Citibank (South Dakota), N.A. in suppt of mot requesting leave to amd removal petn.

		13.	Notc of mot & mot of Citibank (South Dakota) N.A., requesting leave to amd removal petn; [Prop] amd petn for removal, rtnbl 11-2-92 at 9:30 a.m. LODGED Prop Amd notc of removal
9-22-92	dal	14.	Ex parte applic of dft Citibank (South Dakota), N.A. for an ord shortening notc on mot of dft requesting leave to amd removal petn or, in the alt, to cont hrg date on plf Barbara Smiley's mot to Remand. LODGED Ord
9-21-92	dal	15.	Amd notc of mot of Citibank (South Dakota), N.A. requesting leave to amd removal petn.
9-23-92	dal	16.	Decl of Patrick J. Grannan in opp of ex parte applic by dft Citibank for an Ord shortening notc on mot of dft requesting leave to amd removal petn or, in the alt. to cont hrg date on plf's mot to Remand. plfs

9-23-92	dal	17.	Memo of PA in opp to ex parte applic by Ord shortening Notc on mot of dft requesting leave to amd Removal petn or, the alt, to cont hrg date on plf's mot to Remand. plfs
9-24-92	dal	18.	Reply of dft to opp of plf to dft's ex parte applic for an ord shortening notc on mot of dft requesting leave to amnd removal petn or, in the alt, to cont hrg on plf's mot to Remand.
9-24-92	dal	19.	MO: Crt DENIES dft's applic for an Ord shortening time on the hrg re: Citibank's request for leave to amd. But Crt GRANTS dft's request to cont the hrg on plf's mot to Remand frm 10-5-92 to 11-2-92 at 9:30 a.m. Crt finds that the interests of judicial economy will be served by hrg both of these mots of judicial economy will be served by hrg both of these mots together & plf failed, in her opp. to present any strong reasons why this Crt should not grant dft's request to cont the hrg on the mot to Remand. (CR – N/A)

*9-23-92	dal	–	Placed in File Not Used [Prop] Ord granting ex parte applic of Citibank (South Dakota), N.A., for an ord shortening notc on dft's mot requesting leave to amd its notc of removal.
10-19-92	dal	20.	Memo of PA in opp to the mot of Citibank requesting leave to amd the removal petn. plfs
		21.	Decl of Patrick J. Grannan in opp to mot of dft requesting leave to amd notc of removal. plfs
10-26-92	dal	22.	Decl of Patrick J. Grannan in suppt of reply memo on mot to Remand. plfs
		23.	Reply memo of PA in suppt of mot to Remand. plf
		24.	Suppl Appendix of certain authorities cited in reply memo of PA of Citibank (South Dakota), N.A. in suppt of mot requesting leave to amd removal petn.
		25.	Reply memo of PA of Citibank (South Dakota), N.A. in suppt of mot requesting leave to amd removal petn.

10-30-92	bg	26.	Reqst for oral argumnt re mot reqstng leave to amend removal petition & mot to remand. deft
10-30-92	bg	27.	Declar of Ricahrd B Kendall in suppt of reqst for oral argmnt re mot reqstng leave to amend removal petition & mot to remand deft
*10-29-92	bg	28.	Suppl submission of stmnt of interest in suppt of mot reqstng leave to amend removal petition. deft
11-9-92	dal	29.	Resp to dft's suppl subm of stmt of interest of the Office of Comptroller of The Currency in related case, in suppt of Citibank's mot requesting leave to amd removal petn. plf
11/12/92	dm	30.	Objectn to plf's response to supplemental submssn of stmt of int of office of the controller of the currency in related case, in suppt of mot reqst'g lv to amd removal petition. dft
*11/9/92	dm	31.	Declar Patrick J. Grannan in suppt of response to dft's supplmental submssn of stmt of int of the office of the comp

11-13-93	dal	32.	ORD Crt DENIES dft Citibank's mot to and its Notc of Removal & GRANTS plf's request to Reman this actn to Superior Crt of State of CA in & for City & County of L.A. (ENT 1-14-93) (Mld cpy & Notc) (cc: to Superior Crt) MD JS-6
12-5-93	bg	33.	Submission of opinion in related cases. deft
12-13-93	bg	–	prop amended notc of removal NOT USED PLC IN FI

ENTERED ON ICMS

COURT OF APPEAL, SECOND APPELLATE DISTRICT
DIVISION: 7 DATE: 01/23/96

CASENO: 2 Civil B078913 -
Los Angeles NO. BC059202
(S.C. Judge:) >
Cross Ref: B077960

SMILEY, BARBARA
Plaintiff-Appellant

vs.

CITIBANK (SOUTH DAKOTA)
Defendant-Respondent

*** SUMMARY DATA ***

CAUSE: Appeal CASE START DATE: 12/13/93

NOTICE OF APPEAL DATE: 09/23/93

AOB: 12/13/93 RB:01/27/94 ARB: 02/17/94

READY DATE: 02/17/94 SUBMISSION DATE: 04/14/94

STATUS: COMPLETED CATEGORY: Civil Complaints - Other

DISPOSITION: 07/11/94 Affirmed In Full.

OPINION TYPE: Sign Pub >

JUDGES PANEL: ASSIGNED JUSTICE (PT) A C

JUDGES PANEL: LILLIE, MILDRED L. (PJ) P C

JUDGES PANEL: JOHNSON, EARL (J) A D

DOCKET EVENTS

1	10/04/93	CNL	NOTICE OF APPEAL LODGED/ RECEIVED. 9-23-93, SMILEY, B.
2	11/10/93	NNR	RCVD NOTICE PER RULE 5.1 NO REPORTERS TRANSCRIPT 10-1-93
3	12/13/93	AAO	APPELLANT'S APPENDIX AND OPENING BRIEF FILED.
4	12/14/93	LTR	FILED LETTER FROM: REPLACED AOB WITH CLEARER AOB, FILE DATE REMAINED THE SAME
5	12/15/93	SEX	STIPULATION OF EXTENSION OF TIME FILED TO: FILE RBF TO 1-28-94 (NO ORDER NEEDED)
6	12/22/93	SCN	SETTLEMENT CONFERENCE NOTICE SENT.
7	01/27/94	RBF	RESPONDENTS BRIEF FILED.
8	01/27/94	APL	APPLICATION FILED TO: VISA TO FILE AC BRIEF IN SUPPORT OF RESPONDENT (AC BRIEF SUBMITTED CONCURRENTLY)
9	01/27/94	APL	APPLICATION FILED TO: CALIF. BANKERS ASSN TO FILE AC BRIEF IN SUPPORT OF RESPONDENT (AC BRIEF SUBMITTED CONCURRENTLY)
10	01/27/94	RDE	RECEIVED DOCUMENT ENTITLED: RESP'S APPENDIX OF CITED AUTHORITY

11	01/27/94	RDE	RECEIVED DOCUMENT ENTITLED: APPENDIX (RESP) (EXHIBIT A) DECLARATION RE: DCA WRIT PROCEEDING B077960 (?)
12	01/27/94	REQ	REQUEST FILED TO: CITIBANK FOR JUD NTC (FOREIGN AUTHORITY CITED IN BRIEF)
13	01/28/94	OFF	ORDER FILED. DENYING PERMISSION TO FILE RESP'S APPENDIX (EXHIBIT A)
14	02/17/94	ARB	APPELLANT'S REPLY BRIEF FILED.
15	02/17/94	CFB	CASE FULLY BRIEFED.
16	03/14/94	CNS	CALENDAR NOTICE SENT. CALENDAR DATE: APRIL 14, 1994 @ 02:00 PM
17	04/05/94	LTR	FILED LETTER FROM: FR BURKE DTD 3-30-94 RE: RECENT AUTHORITY NOT AVAILABLE AT TIME OF AOB
18	04/11/94	RDE	RECEIVED DOCUMENT ENTITLED: BY RESPONDENT CITIBANK: LEAVE TO FILE RECENT DECISIONS (PERMISSION TO FILE)
19	04/12/94	RDE	RECEIVED DOCUMENT ENTITLED: BY APPELLANT DTD 4-12-94, RECENT DECISIONS FOR ORAL ARGUMENT (PERMISSION TO FILE)

20	04/14/94	CAS	CAUSE ARGUED AND SUBMITTED.
21	04/26/94	LTR	FILED LETTER FROM: FR BURKE DTD 4-25-94 RE: RECENT DECISIONS IN OTHER STATES
22	05/10/94	FDE	FILED DOCUMENT ENTITLED: BY RESPONDENT CITIBANK DTD 5-10-94 RE: RECENT DECISION OF OUT OF STATE CASE (GREENWOOD)
23	06/03/94	LTR	FILED LETTER FROM: FR STRUB DTD 6-2-94 RE: RECENT AUTHORITY
24	07/01/94	RDE	RECEIVED DOCUMENT ENTITLED: ADDITIONAL AUTHORITY FR GRANNAN LETTER FORM DTD 7-1-94 (OPINION ATTACHED) (NEED PERMISSSION TO FILE)
25	07/11/94	OPF	OPINION FILED. AFF/CFP/26/S*-L/J-DISSENT/COSTS TO RESPONDENT
26	08/5/94	OPM	MOD. OF OPINION FILED. (NO CHANGE IN JUDGMENT) MODIFYING DISSENT BY JOHNSON/CFP/8PG
27	08/18/94	LTR	FILED LETTER FROM: MORRISON AND FORSTER DTD 8-17-94
28	09/08/94	RPR	PETITION FOR REVIEW IN SUPREME COURT RECEIVED.

29	09/08/94	TRN	RECORD TRANSMITTED TO SUPREME COURT.
30	10/13/94	ESC	EXT. BY SUPREME CT RE: PETITION FOR REVIEW FILED: 11-18-94
31	10/27/94	RPG	PETITION FOR REVIEW GRANTED IN SUPREME COURT LUCAS DID NOT PARTICIPATE
32	10/11/95	RSC	REMITTITUR RECEIVED FROM SUPREME COURT.
33	10/11/95	RMI	REMITTITUR ISSUED. WITH SUPREME CT REMITTITUR, OPINION, AND DCA OPINI ON ATTACHED (SUPREME CT AFFIRMS DCA OPINION

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FINANCIAL TRANSACTION

1 RECEIPT NO. R228126 DPTY: ART
FEE TYPE: Filing Fee FILING DATE: 09/23/93
PAY/WAIVE DATE: 10/09/93 CR AMT: 250.00
ATTY SEQ:> 1
PAY TYPE: Check FEE STATUS:> Applicable
CHECK NO.> 1968

END OF DOCKET PRINTOUT FOR CASE B078913

SUPREME COURT OF CALIFORNIA

CASE NUMBER S041711

BARBARA SMILEY,

Appellant

v.

CITIBANK (SOUTH DAKOTA) N.A.,

Respondent

TYPE OF PETITION: REVIEW CAUSE: APPEAL
CATEGORY: PETITION FOR REVIEW-CIVIL APPEAL
BRANCH: LA

LOWER COURT INFORMATION
COURT OF APPEAL
DISTRICT: 2 DIVISION: 7 DISPOSITION DATE: 07/11/94 PUBLISHED: Y DISPOSITION: AFFIRMED IN FULL JUSTICE: JOHNSON PROCEEDING:

SUPERIOR COURT
CASE NUMBER BC059202 TYPE NUMBER: SUPER CT # JUDGE: GROVER, MELVIN JUDGEMENT DATE: COUNTY: LOS ANGELES

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(BENJAMIN MILLER)
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DOCKET EVENTS

08/22/94	(PRF)	PETITION FOR REVIEW FILED APPELLANT BARBARA SMILEY
09/07/94	(RCV)	RECEIVED ADDITIONAL AUTHORITIES APPELLANT BARBARA SMILEY
09/13/94	(APR)	ANSWER TO PETITION FOR REVIEW FILED RESPONDENT CITIBANK (W/EXHB ATTACHED) (4ON)
09/13/94	(RDE)	RECEIVED DOCUMENT ENTITLED: RESP'S APPLN TO PERMIT INCLUSION IN APPENDIX
09/13/94	(RDE)	RECEIVED DOCUMENT ENTITLED: RESP'S REQUEST FOR JUDICIAL NOTICE
09/13/94	(RCV)	RECEIVED CA RECORD - ONE DOGHOUSE (VOL 1 OF 3)
09/22/94	(RCV)	RECEIVED C/A RECORD - 2 DOGHOUSES
10/14/94	(EXT)	TIME EXTENDED TO GRANT OR DENY PETITION REVIEW TO 11/18/94
10/27/94	(GRT)	PETITION GRANTED APPELLANT; VOTES: MOS, KEN, BAX, WER, JJ LUC, CJ DID NOT PARTICIPATE

10/28/94	(LTR)	FILED LETTER FROM: COUNSEL FOR APPLT.
10/31/94	(RTC)	RECORD SENT TO COURT B078913:2;3;3 APPNDX; 4; REQT FOR JUDICIAL NOTICE; A/C BRIEFS-2 W/APPLICATIONS; MISC PAPERS. SUPREME CT: 7;8; MISC PAPERS
10/31/94	(PEC)	PREVIOUS ENTRY CONTINUED B077960: PETN FOR W/MANDATE W/4 VOL EXHIBITS; OPPOSITION; ANSWER; A/C BRIEF W/APPLICATION, A/C OPPOSITION; MISC PAPERS.
11/15/94	(REX)	APPLICATION FOR EXTENSION OF TIME FILED TO FILE APLNT B. SMILEY'S BRF. ON MERITS (OPENING) CURRENTLY DUE NOVEMBER 28, 1994.
11/18/94	(EXG)	APPLICATION FOR EXTENSION OF TIME GRANTED APPELLANT'S OPENING BRIEF/MERITS TO 12/16/94
12/16/94	(BMF)	BRIEF ON THE MERITS FILED APLNT. SMILEY'S OPENING + VOL'S., I, II & III OF NON-CALIF. AUTHORITIES
12/16/94	(ACA)	RECEIVED APPLICATION TO FILE AC BRIEF TRIAL LAWYERS FOR PUBLIC JUSTICE ET AL. IN SUPPORT OF APPELLANTS (W/BRIEF)

12/16/94	(ACA)	RECEIVED APPLICATION TO FILE AC BRIEF CONSUMER ACTION IN SUPPORT OF APPLT (W/BRIEF)
12/19/94	(ACA)	RECEIVED APPLICATION TO FILE AC BRIEF STATE OF HAWAII, IOWA, MASSACUSETTS ET AL. IN SUPPORT OF APPLT SMILEY (SAME ATTY REPRESENTS A/C TRIAL LAWYERS FOR PUBLIC JUSTICE ET AL)
12/20/94	(AOG)	FILED ORDER GRANTING PRMSSN TO FILE AC BRF CONSUMER ACTION IN SUPPORT OF APPELLANT, ANS DUE: 1/9/95
12/20/94	(ACB)	AMICUS CURIAE BRIEF FILED BY: CONSUMER ACTION IN SUPPORT OF APPELLANT, ANS DUE: 1/9/95
12/20/94	(AOG)	FILED ORDER GRANTING PRMSSN TO FILE AC BRF STATES OF HAWAII, MARYLAND ET AL. IN SUPPORT OF APPLT. ANS DUE: 1/9/95
12/20/94	(ACB)	AMICUS CURIAE BRIEF FILED BY: STATES OF HAWAII, MARYLAND ET AL. IN SUPPORT OF APPELLANT. ANS DUE: 1/9/95
12/20/94	(AOG)	FILED ORDER GRANTING PRMSSN TO FILE AC BRF TRIAL LAWYERS FOR PUBLIC JUSTICE ET AL. IN SUPPORT OF APPELLANT. ANS DUE: 1/9/95
12/20/94	(ACB)	AMICUS CURIAE BRIEF FILED BY: TRIAL LAWYERS FOR PUBLIC JUSTICE ET AL. IN SUPPORT OF APPLT. ANS DUE: 1/9/95.

01/09/95 (RAC) RESPONSE TO AMICUS CURIAE BRIEF FILED BY: RESPONDENT, CITIBANK (SOUTH DAKOTA) ALL AC BRIEFS IN SUPPORT OF APPELLANT SMILEY

01/17/95 (ACA) RECEIVED APPLICATION TO FILE AC BRIEF FROM MASTERCARD INTERNATIONAL & VISA U.S.A. IN SUPPORT OF RESP CITIBANK (AC & 1 VOLUMNE OF EXHBITS UNDER SEPARATE COVER). *OK ANS DUE 2-9-95*

01/17/95 (ACA) RECEIVED APPLICATION TO FILE AC BRIEF FROM CALIFORNIA BANKERS ASSN ET AL IN SUPPORT OF RESP CITIBANK. (AC UNDER SEPARATE COVER). * OK ORDER BEING PREPARED* ANS: 2-9-95

01/17/95 (ACA) RECEIVED APPLICATION TO FILE AC BRIEF STATES OF ARIZONA, DELAWARE, LOUISIANA ET AL. IN SUPPORT OF RESP CITIBANK (BRIEF & APPL BOUND TOGETHER)

01/17/95 (MOF) MOTION FILED APPEAR PRO HAC VICE BY WOLF, BLOCK ET AL ON BEHALF OF AMICUS GREENWOOD TRUST COMPANY, PHILADELPHIA, PA (AMICUS BRIEF ATTACHED). RCVD AMENDED P/S STATE BAR

01/17/95 (ACA) RECEIVED APPLICATION TO FILE AC BRIEF AND BRIEF OF GREENWOOD TRUST COMPANY IN SUPPORT OF RESP CITIBANK

01/18/95 (ACA) RECEIVED APPLICATION TO FILE AC BRIEF FROM COMPTROLLER OF THE CURRENCY IN SUPPORT OF RESP CITIBANK

01/19/95 (AOG) FILED ORDER GRANTING PRMSSN TO FILE AC BRF STATES OF ARIZONA, DELAWARE, LOUISIANA ET AL IN SUPPORT OF RESPONDENT. ANS DUE: 2/9/95

01/19/95 (ACB) AMICUS CURIAE BRIEF FILED BY: STATES OF ARIZONA, DELAWARE ET AL. IN SUPPORT OF RESPONDENT. ANS DUE: 2/9/95

01/17/95 (FIL) FILED RESPONDENT'S APPENDIX OF CERTAIN CITED AUTHORITIES VOLS I THRU IV [SEE DOCKET #41 FOR NEXT SEQUENTIAL DOCKET ENTRY]

01/23/95 (AOG) FILED ORDER GRANTING PRMSSN TO FILE AC BRF CALIFORNIA BANKERS ASSN ETC ET AL. IN SUPPORT OF RESP CITIBANK. ANS DUE 2/9/95

01/23/95 (ACB) AMICUS CURIAE BRIEF FILED BY: CALIFORNIA BANKERS ASSN ETC ET AL IN SUPPORT OF RESP CITIBANK. ANS DUE: 2/9/95.

01/23/95 (AOG) FILED ORDER GRANTING PRMSSN TO FILE AC BRF MASTERCARD INT'L & VISA USA IN SUPPORT OF RESP. ANS DUE: 2/9/95

01/23/95 (ACB) AMICUS CURIAE BRIEF FILED BY: MASTERCARD INT'L & VISA USA IN SUPPORT OF RESP CITIBANK W/1 VOL EXHIBITS (ANS DUE: 2/9/95)

01/25/95 (AOG) FILED ORDER GRANTING PRMSSN TO FILE AC BRF OFFICE OF THE COMPTROLLER OF THE CURRENCY IN SUPPORT OF RESPONDENT. BRIEF DUE: 1/31/95. ANS DUE: 2/21/95

01/26/95 (RCV) RECEIVED 3 ADD'L DOGHOUSES IN B0778913 FROM CA 2 – ROUTED TO COURT

01/17/95 (RQJ) REQUEST FILED TO TAKE JUDICIAL NOTICE RESPONDENT CITIBANK [***OUT OF SEQUENCE***]

01/30/95 (OPO) OPPOSITION FILED BY: APLNT. BARBARA SMILEY/ OPPOSING RESPS'. MOTION REQUESTING JUDICIAL NOTICE OF CITED AUTHORITIES.

01/31/95 (RCV) RECEIVED AMENDED PROOF/ SERVICE ON STATE BAR BY WOLF, BLOCK ET AL & MCCUTCEN DOYLE (PRO HAC VICE AMICUS GREENWOOD TRUST COMPANY)

01/17/95 (AMF) ANSWER BRIEF ON THE MERITS FILED RESP CITIBANK (NOT DOCKETED AT TIME OF FILING)

01/31/95 (ACB) AMICUS CURIAE BRIEF FILED BY: OFFICE OF COMPTROLLER OF THE CURRENCY (ANS DUE: 2-21-95

02/03/95 (FIL) FILED RESPONSE TO OPPOSITION TO MOTION REQUESTING JUDICIAL NOTICE. FILED BY: RESP. CITIBANK

02/06/95 (RMF) REPLY BRIEF ON THE MERITS FILED APPELLANT, BARBARA SMILEY AND 1 VOLUME OF APPENDIX OF NON-CALIFORNIA AUTHORITY SUPPORTING APPELLANT'S REPLY BRIEF

02/07/95 (RCV) RECEIVED NOTICE OF CHANGE OF FIRM NAME & ADDRESS OF ATY FOR PROPOSED AMICUS GREENWOOD TRUST COMPANY & PARTIAL WITHDRAWAL OF MOTN PRO HAC VICE JEFFREY SALTZ.

02/07/95 (ORF) ORDER FILED: ADMISSION PRO HAC VICE ALAN S. KAPLINSKY AND BURT M. RUBLIN, STATE OF PENNSYLVANIA, ON BEHALF OF AMICUS GREENWOOD TRUST COMPANY IS GRANTED.

02/08/95 (AOG) FILED ORDER GRANTING PRMSSN TO FILE AC BRF ALAN S. KAPLINSKY AND BURT M. RUBLIN OF THE STATE OF PENNSYLVANIA [GREENWOOD TRUST COMPANY]

02/08/95	(ACB)	AMICUS CURIAE BRIEF FILED BY: ALAN S. KAPLINSKY AND BURT M. RUBLIN OF THE STATE OF PENNSYLVANIA [GREENWOOD TRUST COMPANY] IN SUPPORT OF RESPONDENT
02/21/95	(ACB)	AMICUS CURIAE BRIEF FILED BY: OFFICE OF COMPTROLLER OF THE CURRENCY IN SUPPORT OF RESP. CITIBANK
02/23/95	(LTR)	FILED LETTER FROM: RESP. CITIBANK (SO. DAKOTA) N.A., NOTIFYING THE CRT. OF A RECENT LETTER FROM JULIE L. WILIAMS, CHIEF-COUNSEL, OFC. OF COMPTROLLER OF THE CURRENCY.
03/07/95	(LTR)	FILED LETTER FROM: APPELLANT, SMILEY OPPOSING LETTER FROM RESPONDENT CITIBANK (SOUTH DAKOTA)
03/15/95	(FIL)	FILED BY RESP/CITIBANK, LTR/BRF OPPOSING LTR/BRF FILED BY APLNT/SMILEY
03/15/95	(FIL)	FILED LTR. ADVISING CRT. OF PROPOSED REVISIONS BY THE OFC. OF THE COMPTROLLER OF THE CURRENCY. FILED BY RESP/CITIBANK
04/13/95	(ORF)	ORDER FILED: APPLICATION OF CYNTHIA ST. JOHN & BENJAMIN MILLER TO FILE ACB IS DENIED W/O PREJUDICE TO A RENEWED APPLICATION SHOWING THE ABSENCE OF UNDUE DELAY.<<<

04/17/95	(RCV)	RECEIVED RENEWED APPLICATION TO FILE A/C BRIEF FROM CYNTHIA ST. JOHN ET AL.
04/18/95	(AOG)	FILED ORDER GRANTING PRMSSN TO FILE AC BRF RE-APPLICATION OF CYNTHIA ST. JOHN AND BENJAMIN MILLER IN SUPPORT OF APPLNT. ANSWER DUE: 4/28/95
04/28/95	(FIL)	FILED BY RESP. CITIBANK (S.D.), N.A.; ANSWER TO ACB OF CYNTHIA ST. JOHN & BENJAMIN MILLER.
05/01/95	(ACA)	RECEIVED APPLICATION TO FILE AC BRIEF CHASE MANHATTAN BANK, N.A. IN SUPPORT OF RESP (APPLICATION ONLY)
05/02/95	(LTR)	FILED LETTER FROM: APLT SMILEY DATED 5-2-95 RE; ADDITIONAL AUTHORITIES.
05/03/95	(AOG)	FILED ORDER GRANTING PRMSSN TO FILE AC BRF CHASE MANHATTAN BANK, N.A. IN SUPPORT OF RESP BRIEF DUE: 5/8/95 ANSWER DUE: 5/15/95
05/03/95	(CHA)	CHANGE OF ADDRESS FILED FOR: BY: RESP. CITIBANK (SOUTH DAKOTA), N.A.
05/04/95	(COC)	CASE ORDERED ON CALENDAR: 6-6-95, 9AM, L.A.

05/09/95	(ACB)	AMICUS CURIAE BRIEF FILED BY: BY COUNSEL FOR CHASE MANHATTAN BANK (IN SUPPORT OF RESP., CITIBANK) PERM GRANTED.
05/09/95	(RJN)	REQUEST FOR JUDICIAL NOTICE FILED BY COUNSEL FOR A/C CHASE MANHATTAN BANK.
05/15/95	(NOT)	NOTE: MAIL RE-SENT TO AMICUS ATTY MADDEN (MCCUTCHEN, DOYLE, ETC.)
05/15/95	(LTR)	FILED LETTER FROM: APLNT. SMILEY [-ADVISING COURT APLNT. WILL NOT BE FILING AN ANSWER TO BRF. OF AMICUS CURIAE – MANHATTAN CHASE BANK, N.A.-]
05/18/95	(LTR)	FILED LETTER FROM: APLNT. SMILEY APPRISING THE COURT OF ADD'L. AUTHORITIES.
05/23/95	(RES)	RESPONSE FILED BY RESP> CITY BANK (SO. DAKOTA) TO LETTER OF APLNT. OF ADD'L AUTHORITIES.
05/30/95	(LTR)	FILED LETTER FROM: RESP CITING ADDITIONAL AUTHORITIES
06/06/95	(CCA)	CAUSE CALLED AND ARGUED
06/06/95	(SUB)	SUBMITTED

09/01/95	(OPF)	OPINION FILED AFFIRMED. OPINION BY: MOSK, ACTING C.J. JOINED BY: KEN, BAX, WER, ARDAIZ, (ASSIGNED) JJ DISSENT; ARABIAN, J. DISSENT: GEORGE, J.
10/03/95	(RMI)	REMITTITUR ISSUED WITH CERTIFIED COPIES SENT TO CA/2
10/13/95	(RCV)	RECEIVED RECEIPT FOR REMITTITUR FROM CA/2
12/08/95	(RDE)	RECEIVED DOCUMENT ENTITLED: NOTICE OF FILING OF PETITION FOR WRIT OF CERTIORARI IN UNITED STATES SUPREME COURT.
01/26/96	(RLF)	RECEIVED LETTER FROM: USSC DATED 1-19-96: CERT GRANTED. BRIEFS DUE MARCH 1 AND MARCH 29.

****CASE NOTES***
****PUBLISHED AT 11 CAL 4TH 138****

END OF DOCKET INFORMATION FOR CASE NUMBER S041711

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Attorneys for Defendants
CITIBANK (SOUTH DAKOTA), N.A.

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

BARBARA SMILEY, On Behalf of Herself and All Others Similarly Situated, Plaintiff, vs. CITIBANK (SOUTH DAKOTA), N.A., Defendants.	Case No. BC059202 ANSWER AND AFFIRMATIVE DEFENSES OF DEFENDANT CITIBANK (SOUTH DAKOTA), N.A. TO COMPLAINT FOR DAMAGES AND INJUNCTIVE RELIEF JURY TRIAL DEMANDED

Defendant Citibank (South Dakota) N.A. ("Citibank"), for itself and no others, for its answer to the Complaint for Damages and Injunctive Relief (the "Complaint"), admits, denies, and alleges as follows:

INTRODUCTION

1. Answering paragraph 1, Citibank admits that plaintiff Barbara Smiley ("Plaintiff" or "Smiley") purports

to bring this case on her own behalf and on behalf of certain other persons described therein, but Citibank denies that a class action is appropriate. Citibank is unable to comprehend the second sentence of paragraph 1, which avers that "Citibank has charged the plaintiff and other similarly situated persons (South Dakota), N.A. the late charges that are the subject of this action," but Citibank alleges that Citibank (South Dakota) N.A. has charged Plaintiff late payment charges on her credit card accounts in accordance with the terms of her written card agreements. Except as so admitted and alleged, Citibank denies each and every allegation of paragraph 1.

2. Answering paragraph 2, Citibank admits that it issues credit cards. Citibank alleges that late payments by customers require additional processing and thereby result in an increase in processing costs. Citibank alleges that Citibank intends to continue to contract for and collect late payment charges and that it has not issued a warning in California regarding the purported illegality of such charges because such charges do not violate any applicable law. Except as so admitted and alleged, Citibank denies each and every allegation of paragraph 2.

3. Answering paragraph 3, Citibank denies each and every allegation contained therein.

4. Answering paragraph 4, Citibank admits that the Complaint seeks certain relief described therein. Citibank alleges that it charges late payment charges on its credit card accounts in accordance with the terms of its card agreements. Citibank alleges that it has not issued a warning in California regarding the purported illegality of such charges because such charges do not violate any

applicable law. Except as so admitted and alleged, Citibank denies each and every allegation of paragraph 4.

PARTIES

5. Answering paragraph 5, Citibank alleges that it has charged Plaintiff late payment charges on her Mastercard and Preferred Visa credit card accounts in accordance with the terms of the card agreements. With respect to the remaining allegations in paragraph 5, Citibank lacks knowledge or information sufficient to form a belief as to the truth of those allegations, and on that basis denies each and every such allegation.

6. Answering paragraph 6, Citibank alleges that it is a national banking association chartered and located in South Dakota with its principal place of business in South Dakota. Citibank denies that any entity exists known as "Citicorp, Inc.," but Citibank alleges that there is an entity known as "Citicorp," that Citibank is a wholly owned subsidiary of Citicorp, and that Citicorp is a Delaware corporation with its principal place of business in New York, New York. Citibank alleges that it issues Citibank credit cards to California residents, as well as those of certain other States. Except as so alleged, Citibank denies each and every allegation of paragraph 6.

7. Answering paragraph 7, Citibank denies each and every allegation contained therein.

JURISDICTION AND VENUE

8. Answering paragraph 8, Citibank alleges that complete diversity of citizenship exists between each

Plaintiff and each defendant in this action and, therefore, that this Court has original jurisdiction over this action. Citibank alleges that the Superior Court of the State of California for the County of Los Angeles (the "Superior Court") has concurrent jurisdiction over this action. Except as so alleged, Citibank denies each and every allegation of paragraph 8.

9. Answering paragraph 9, Citibank alleges that it issues credit cards. Citibank alleges that the courts of the State of California, including this Court, have personal jurisdiction over Citibank. Except as so alleged, Citibank denies each and every allegation of paragraph 9.

10. Answering paragraph 10, Citibank alleges that the matter in controversy exceeds the sum or value of $50,000, exclusive of interest and costs. Citibank alleges that venue is proper in this Court. Citibank admits that the matter in controversy exceeds the jurisdictional minimum of the Superior Court. Citibank alleges that Plaintiff and certain California residents who reside in Los Angeles County have paid late payment charges on their credit card accounts in accordance with the terms of their written card agreements. Except as so admitted and alleged, Citibank denies each and every allegation of paragraph 10.

CLASS ACTION ALLEGATIONS

11. Answering paragraph 11, Citibank admits that Plaintiff purports to bring this case on her own behalf and on behalf of certain other persons described therein, but Citibank denies that a class action is appropriate.

Except as so admitted, Citibank denies each and every allegation of paragraph 11.

12. Answering paragraph 12, Citibank alleges that it issues credit cards to California residents. Citibank alleges that it has received late payment charges from customers in California in accordance with the terms of their written card agreements. Except as so alleged, Citibank denies each and every allegation of paragraph 12.

13. Answering paragraph 13 including without limitation all subparts thereof, Citibank denies each and every allegation of paragraph 13.

14. Answering paragraph 14, Citibank admits that Plaintiff has retained counsel who are competent and experienced in class action litigation. Except as so admitted, Citibank denies each and every allegation of paragraph 14.

15. Answering paragraph 15, Citibank alleges that it receives late payment charges from customers in accordance with the terms of their written card agreements. Except as so alleged, Citibank denies each and every allegation of paragraph 15.

16. Answering paragraph 16, Citibank denies each and every allegation of paragraph 16.

17. Answering paragraph 17, Citibank alleges that as of the date hereof it charges to certain accounts of certain of its customers in California, pursuant to such customers' card agreements, a late payment fee of up to $15 for each billing period in which such customers' minimum payment is not received within 25 days after such customers' payment due date. Citibank alleges that

as of the date hereof it charges to certain preferred accounts of certain of its customers in California, pursuant to such customers' preferred card agreements, a late payment fee of up to $6 for each billing period in which such customers' minimum payment is not received within 15 days after such customers' payment due date; if such payment is not received as of such customers' next payment due date, such preferred accounts are charged an additional fee equal to the greater of $15 or .65 percent of such customers' account balance. Except as so alleged, Citibank denies each and every allegation of paragraph 17.

18. Answering paragraph 18, Citibank denies each and every allegation of paragraph 18.

19. Answering paragraph 19, Citibank denies each and every allegation of paragraph 19.

20. Answering paragraph 20, Citibank denies each and every allegation of paragraph 20.

21. Answering paragraph 21, Citibank denies each and every allegation of paragraph 21.

22. Answering paragraph 22, Citibank denies each and every allegation of paragraph 22.

23. Answering paragraph 23, Citibank alleges that Citibank intends to continue to contract for and collect late payment charges. Except as so alleged, Citibank denies each and every allegation of paragraph 23.

FIRST CAUSE OF ACTION

(Unlawful Business Practices in violation of California Business and Professions Code § 17200 *et seq.*)

24. Answering paragraph 24, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 23 herein.

25. Answering paragraph 25, Citibank respectfully refers the Court to section 17200 of the California Business and Professions Code for the precise language of that statute. Citibank otherwise denies each and every allegation of paragraph 25.

26. Answering paragraph 26, Citibank denies each and every allegation of paragraph 26.

27. Answering paragraph 27, Citibank denies each and every allegation of paragraph 27.

28. Answering paragraph 28, Citibank denies each and every allegation of paragraph 28.

29. Answering paragraph 29, Citibank admits that Plaintiff seeks the relief described therein. Except as so admitted, Citibank denies each and every allegation of paragraph 29.

30. Answering paragraph 30, Citibank denies each and every allegation of paragraph 30.

SECOND CAUSE OF ACTION

(Breach of Duty of Good Faith and Fair Dealing)

31. Answering paragraph 31, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 30 herein.

32. Answering paragraph 32, Citibank denies each and every allegation of paragraph 32.

33. Answering paragraph 33, Citibank denies each and every allegation of paragraph 33.

34. Answering paragraph 34, Citibank is not required to deny allegations as to damages, *see* Fed. R. Civ. P. 8(d), but Citibank denies that Plaintiff has suffered any actionable injury or damages related in any way to the claims set forth in the Complaint.

THIRD CAUSE OF ACTION

(Violation of Civil Code § 1671)

35. Answering paragraph 35, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 34 herein.

36. Answering paragraph 36, Citibank denies each and every allegation of paragraph 36.

37. Answering paragraph 37, Citibank denies each and every allegation of paragraph 37.

FOURTH CAUSE OF ACTION

(Unjust Enrichment and
Imposition of Constructive Trust)

38. Answering paragraph 38, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 37 herein.

39. Answering paragraph 39, Citibank denies each and every allegation of paragraph 39.

40. Answering paragraph 40, Citibank denies each and every allegation of paragraph 40.

FIFTH CAUSE OF ACTION

(Fraud and Deceit)

41. Answering paragraph 41, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 40 herein.

42. Answering paragraph 42, Citibank denies each and every allegation of paragraph 42.

43. Answering paragraph 43, Citibank denies each and every allegation of paragraph 43.

44. Answering paragraph 44, Citibank denies each and every allegation of paragraph 44.

45. Answering paragraph 45, Citibank is not required to deny allegations as to damages, *see* Fed. R. Civ. P. 8(d), but Citibank denies that Plaintiff has suffered any actionable injury or damages related in any way to the claims set forth in the Complaint.

46. Answering paragraph 46, Citibank denies each and every allegation of paragraph 46.

47. Answering paragraph 47, Citibank denies each and every allegation of paragraph 47.

SIXTH CAUSE OF ACTION

(Negligent Misrepresentation)

48. Answering paragraph 48, Citibank refers to, realleges, and incorporates herein by reference each and every response set forth in paragraphs 1 through 47 herein.

49. Answering paragraph 49, Citibank denies each and every allegation of paragraph 49.

50. Answering the third sentence of paragraph 50, Citibank is not required to deny allegations as to damages, *see* Fed. R. Civ. P. 8(d), but Citibank denies that Plaintiff has suffered any actionable injury or damages related in any way to the claims set forth in the Complaint. With respect to the remaining allegations in paragraph 50, Citibank lacks knowledge or information sufficient to form a belief as to the truth of those allegations, and on that basis denies each and every allegation contained therein.

SEVENTH CAUSE OF ACTION

(Breach of Contract and Rescission)

51. Answering paragraph 51, Citibank refers to, realleges, and incorporates herein by reference each and

every response set forth in paragraphs 1 through 50 herein.

52. Answering paragraph 52, Citibank alleges that Plaintiff entered into written card agreements with Citibank and that any late payment charges to Plaintiff's accounts were legal and permissible under a11 applicable laws. Except as so alleged. Citibank denies each and every allegation of paragraph 52.

53. Answering paragraph 53, Citibank denies each and every allegation of paragraph 53.

54. Answering paragraph 54, Citibank is not required to deny allegations as to damages, *see* Fed. R. Civ. P. 8(d), but Citibank denies that Plaintiff has suffered any actionable injury or damages related in any way to the claims set forth in the Complaint.

AFFIRMATIVE DEFENSES

55. By alleging the matters set forth in paragraphs 56 through 70 below under the heading "Affirmative Defenses," Citibank does not thereby allege, admit, concede, or imply that Citibank has the burden of proof with respect to all or any part of any such matters.

FIRST AFFIRMATIVE DEFENSE

(Failure to State a Cause of Action)

56. The Complaint, and each purported cause of action therein, fails to state facts sufficient to constitute a cause of action against Citibank.

SECOND AFFIRMATIVE DEFENSE

(Federal preemption of State Law)

(All Causes of Action)

57. Plaintiff is barred from obtaining any relief as pleaded in the Complaint, because the California law on which Plaintiff's claims are based is preempted by the federal banking laws including without limitation the National Bank Act and regulations promulgated thereunder and by the Supremacy Cause of the United States Constitution.

THIRD AFFIRMATIVE DEFENSE

(Accord and Satisfaction)

(All Causes of Action)

58. Plaintiff is barred by an accord and satisfaction from obtaining any relief as pleaded in the Complaint, because Citibank has fully performed any and all duties and obligations required to be performed by it and has satisfied any and all conditions required to be satisfied by it pursuant to the terms of any agreement with plaintiff, except such duties, obligations, and conditions the performance or satisfaction of which was prevented or excused by the acts or omissions of Plaintiff or parties other than Citibank.

FOURTH AFFIRMATIVE DEFENSE

(Estoppel)

(All Causes of Action)

59. Plaintiff is estopped by her conduct from claiming that Citibank is in any way at fault as alleged in the Complaint, because, by way of example only and not limitation, Plaintiff at all relevant times was aware of and acquiesced in the alleged facts and events of which she now complains.

FIFTH AFFIRMATIVE DEFENSE

(Laches)

(First, Third, and Fourth Causes of Action)

60. Plaintiff is barred by laches from obtaining any relief on any actions in equity pleaded in the Complaint, because Plaintiff has unjustifiably delayed in bringing her Complaint and Citibank has been prejudiced thereby.

SIXTH AFFIRMATIVE DEFENSE

(Limitation of Actions)

(All Causes of Action)

61. Plaintiff is barred by the applicable statutes of limitation, as set forth in sections 336 *et seq.* of the California Code of Civil Procedure from obtaining any relief as Pleaded in the Complaint.

SEVENTH AFFIRMATIVE DEFENSE

(Waiver)

(All Causes of Action)

62. If there has been any event entitling Plaintiff to relief against Citibank as pleaded in the Complaint, which Citibank denies, Plaintiff has, by reason of her conduct, waived any claims against Citibank that she might otherwise have. By way of example only and not limitation, Plaintiff failed to notify Citibank of any alleged wrongdoing by Citibank within a reasonable time after she discovered or should have discovered such alleged wrongdoing.

EIGHTH AFFIRMATIVE DEFENSE

(Unclean Hands)

(All Causes of Action)

63. Plaintiff is barred from obtaining any relief as pleaded in the Complaint by the doctrine of unclean hands, because of, by way of example only and not limitation, Plaintiff's conduct as alleged in paragraphs 59 and 62 herein and otherwise.

NINTH AFFIRMATIVE DEFENSE

(Lack of Proximate Cause)

(All Causes of Action)

64. Any and all actions or failures to act by Citibank were not the proximate cause of any injury or damages suffered or to be suffered by Plaintiff. Such injury or damages, if any, were proximately caused by actions or

failures to act by Plaintiff or by actions or failures to act by parties other than Citibank.

TENTH AFFIRMATIVE DEFENSE

(Failure to Mitigate)

(All Causes of Action)

65. Plaintiff is barred from obtaining any relief as pleaded in the Complaint because of Plaintiff's failure to take reasonable, necessary, appropriate, and feasible steps to mitigate her damages, if any.

ELEVENTH AFFIRMATIVE DEFENSE

(No Entitlement to Punitive Damages)

(Fifth Cause of Action)

66. Any alleged conduct of Citibank does not satisfy the standard for recovery by Plaintiff of punitive damages set forth in California Civil Code section 3294.

TWELFTH AFFIRMATIVE DEFENSE

(Illegality of Punitive and Treble Damages Award)

(First and Fifth Causes of Action)

67. All or part of any award of punitive damages or treble damages against Citibank would violate Citibank's rights under the federal banking laws and under the United States Constitution and the California Constitution.

THIRTEENTH AFFIRMATIVE DEFENSE

(Comparative Fault)

(All Causes of Action)

68. If any injury or damage occurred as alleged in the Complaint, such injury or damage was caused or contributed to, in whole or in part, by the actions, omissions, or fault of Plaintiff or parties other than Citibank.

FOURTEENTH AFFIRMATIVE DEFENSE

(Plaintiff's Default)

(Seventh Cause of Action)

69. Plaintiff is barred from obtaining any relief on her cause of action for breach of contract and rescission, because Plaintiff has defaulted on her contractual obligations to Defendant.

FIFTEENTH AFFIRMATIVE DEFENSE

(No Entitlement to Attorney's Fees)

(All Causes of Action)

70. Any recovery by Plaintiff by way of the Complaint does not satisfy the standard for recovery by Plaintiff of attorney fees set forth in section 1021.5 of the California Code of Civil Procedure.

SIXTEENTH AFFIRMATIVE DEFENSE

(Set-Off)

(All Causes of Action)

71. To the extent Plaintiff is found to have been damaged by any action or inaction of Defendant, Defendant is entitled to off-set such damages by any amounts owed to Defendant by Plaintiff.

WHEREFORE, Citibank prays that:

1. Plaintiff takes nothing by her Complaint;

2. Citibank recovers its costs of suit and reasonable expenses incurred herein, including without limitation attorneys' fees; and

3. Citibank recovers such other and further relief as this Court deems just and proper.

Dated: August 12, 1992

SHEARMAN & STERLING
William M. Burke
Richard B. Kendall
Michael H. Strub, Jr.

By /s/ Richard B. Kendall
Richard B. Kendall

Attorneys for Defendant
CITIBANK (SOUTH
DAKOTA), N.A.

[Certificates Of Service Omitted In Printing]

Exhibits to Declaration of Michael H. Strub, Jr. in Support of Opposition of Citibank (South Dakota), N.A. to Motion of Barbara Smiley to Remand, filed in U.S. District Court for the Central District of California, Sept. 21, 1992, after removal but before remand to state court

CITIBANK CLASSIC CARD AGREEMENT

This is your Citibank Classic Card Agreement. Please read it and keep it for your records. You do not have to sign the Agreement. In the Agreement, the word *card* means either one or more cards; the words, *you, your* and *yours* mean the cardmember as well as anyone the cardmember permits to use the card; the words *we, us* and *our* mean Citibank (South Dakota), N.A. The words *Citibank Classic checks* mean one or more checks that we may send to you to access your Citibank Classic account.

Credit Line:

Your initial credit line will appear on the folder containing your card. A portion of your credit line will be available for cash advances. At our discretion we may change your credit line or cash advance limit at any time. We will notify you if we do, either by mail or through your monthly billing statement. You may request a change to your credit line or cash advance limit by contacting Citibank Customer Service by phone or mail.

Card Uses/Credit Line:

You must sign the card in order to use it. Your initial credit line will appear on the folder containing your card. This full amount is available to buy or lease goods or services wherever the card is honored. A portion of your

credit line will also be available for cash advances (cash loans) at any bank or automated teller machine that accepts the card or by using Citibank Classic checks. The total amount charged on your account, including purchases, cash advances, finance charges, fees, or other charges, must always remain below your credit line.

Additional Cards:

You may request additional cards on your account for yourself or others by contacting Citibank Customer Service. You are responsible for the use of each card according to the terms of this Agreement.

Annual Membership Fee:

You will pay us a non-refundable annual membership fee of $20. This fee will be added to your purchase balance on your first monthly billing statement and annually thereafter.

Billing:

We will send you a monthly billing statement when there is activity on your account. Your monthly statement will show your new balance, any finance charges, the minimum amount due, and the payment due date. In addition, it will show your current credit line and cash advance limit, an itemized list of current charges, Citibank Classic check transactions, payments and credits, a summary showing separately your purchase account, your cash advance account and finance charges on each,

as well as other information concerning your account. You must notify us of a change in your address.

New Balance:

To determine your New Balance, we begin with the outstanding balance on your account at the beginning of each billing period – called the "Previous Balance" on your billing statement. We then add any purchases and cash advances that are recorded on your account and subtract any payments and credits received. We then add any other adjustments (for example, corrections of a prior calculation) and finally add the appropriate finance charges and fees.

Finance Charges on Purchases:

We will add a finance charge if you do not pay the New Balance listed on your last monthly statement in full on or before its payment due date. When you do not pay your New Balance in full (that is, if you choose to revolve), we will assess finance charges on purchases as follows:

■ We start with the purchase balance at the beginning of your monthly billing period and will add to that any unpaid finance charges. This is called the "Previous Balance" on your statement Your monthly billing period begins the day of your statement date and varies with the number of days in that billing month.

■ On each day of the billing period we subtract payments, we add new purchases, and we make adjustments (e.g. for credited returns, prior statement errors, and the

like). This determines a daily balance. Unless we elect to use a later date, we add purchases to the balance as of the date of the purchase.

■ We total the daily balances, and then divide that figure by the number of days in the billing period. This determines the average daily balance, which is the "balance subject to finance charge."

■ We multiply the "balance subject to **finance charge**" by 1.65%, the monthly periodic rate, which corresponds to a 19.8% **annual percentage rate**. This amount is your **finance charge** on purchases.

Finance Charges On Cash Advances:

We will add a finance charge for your cash advances from the day you take the cash advance until the day we receive payment in full. We determine the amount of the finance charge as follows

■ We start with the cash advance balance at the beginning of your monthly billing period and will add to that any unpaid cash advance finance charges. This is called the "Previous Balance" on your statement.

■ On each day of the billing period we subtract payments, we credit adjustments, and we add new cash advances, other adjustments, and unpaid finance charges. This determines a daily balance. Unless we elect to use a later date, we add cash advances to the balance as of the day they are taken.

■ We total the daily balances, and then divide that figure by the number of days in the billing period. This determines the "balance subject to finance charge"

■ We multiply the "balance subject to **finance charge**" by 0.05424%, the daily periodic rate, which corresponds to a 19.8% **annual percentage rate**. We then multiply the resulting amount by the number of days in the billing period. This amount is your **finance charge** on cash advances.

Finance Charges – Cash Advance Transaction Fee:

We will also add an additional **finance charge** for each cash advance transaction if you obtain the cash advance at an Automated Teller Machine (ATM), this additional **finance charge** will be $1.75. If you obtain the cash advance via a Citibank Classic check, or at a bank or other finance institution (without using an ATM), this additional **finance charge** will equal 2% of the amount of each cash advance; however, it will not be less than $2.00 or more than $10.00. The cash advance transaction fee will cause the Annual Percentage Rate on your billing statement on which the transaction first appears to exceed the rate stated above.

Minimum Finance Charge:

If your finance charge for purchases or cash advances is less than 50¢, we will impose in each case a minimum **finance charge** of 50¢. We will charge the amount at our discretion to either your purchase or cash advance balance.

Charges Made in Foreign Currencies:

FOR VISA ACCOUNTS: If you incur a charge in a foreign currency, the charge will be converted by Visa International into a U.S. dollar amount. Visa International will use the procedures set forth in its Operating Regulations in effect at the time that the transaction is processed. Currently, those Regulations provide that the currency conversion rate to be used is either (1) a wholesale market rate or (2) a government-mandated rate in effect one day prior to the processing date, increased by one percent in each case; Visa retains this one percent as compensation for performing the currency conversion service. The currency conversion rate in effect on the processing date may differ from the rate in effect on the transaction date or the posting date.

FOR MASTERCARD ACCOUNTS: If you incur a charge in a foreign currency, the charge will be converted by MasterCard International, Inc., into a U.S. dollar amount. MasterCard International will use the conversion procedures published from time-to-time to its members at the time that the transaction is processed. Currently, the currency conversion rate used to determine the transaction amount in U.S. dollars is either (1) a wholesale market rate or (2) a government-mandated rate in effect one day prior to the processing date, increased by one percent in each case; MasterCard retains this one percent as compensation for performing the currency conversion service. The currency conversion rate in effect on the processing date may differ from the rate in effect on the transaction date or the posting date.

Minimum Amount Due:

The minimum payment will be the total of the following:

- Your New Balance if it is less than $20, or $20 if your New Balance is between $20 and $720 (however, if your billed finance charges exceed $20, your minimum payment will be the amount of your billed finance charges), or, if it is more than $720, $1/36$th of your New Balance, rounded to the next dollar;
- Any amount past due; and
- Any amount in excess of your credit line.

You must pay at least the minimum payment each month, but you may pay more than that amount at any time without a penalty. The sooner you pay your New Balance, the less you will have to pay in finance charges.

Payments:

We can accept late or partial payments as well as payments that are marked "paid in full" or other restrictive endorsements, without losing any of our rights under this Agreement. If you pay more than the minimum amount due, we will allocate the excess amount to your purchase or cash advance balance at our discretion, unless you tell us otherwise. You must pay us in U.S. dollars drawn on funds on deposit in the United States. However, we reserve the right to accept payments made in Canadian currency. If we do, we will charge you a currency conversion fee based upon the "spot" rates existing at the time of conversion. Please do not send us cash payments.

Exceeding Your Credit Line:

We will charge your account an over the credit line fee of $10 for each billing period in which your New Balance exceeds your credit line This fee will be added to your purchase balance

Late Payments:

We will charge your account a late payment fee of $15 for each billing period in which your minimum payment is not received within 25 days after your payment due date. This fee will be added to your purchase balance.

Returned Payments:

We will charge your account a $15 fee if your check or similar payment instrument is not honored or if we must return it to you because it cannot be processed. This fee will be added to your purchase balance.

Cardmember Lists:

On occasion, we make our membership list available to selected companies whose products and services we hope will appeal to cardmembers like you. You may request that your name not be given to outside companies by writing to us at the address listed on your monthly bill or calling us via the 800# on your monthly statement. Please be sure to include your name, address and account number. Allow 8-10 weeks for your request to take effect.

Citibank Classic Checks:

You can use your personalized Citibank Classic checks to purchase goods and services or to obtain cash up to the amount of your available cash advance limit unless that amount will cause you to exceed your credit line. We will treat Citibank Classic checks as a cash advance and will charge them against your cash advance limit. We may decline to honor a Citibank Classic Check if you are over your cash advance limit or credit line, you are in default, your account privileges have been cancelled, or your card has expired. If we do, we will charge you a $15 fee, which we will add to your cash advance balance. Citibank Classic checks may be used only by the person whose name is printed on them. You may not use Citibank Classic checks to pay any amount which you owe us on this or any other bankcard agreement with us. We will not certify any Citibank Classic checks, nor will we return paid Citibank Classic checks to you.

Lost or Stolen Cards/Citibank Classic Checks:

If your card or Citibank Classic checks are lost or stolen or if you are afraid someone used or may use them without your permission, you must notify us at once by calling the telephone number shown on your monthly statement or the number you get by calling toll-free information or your local Directory Assistance. We may require you to provide us certain information in writing to help us find out what happened. Don't use the card or the Citibank Classic checks after you've notified us, even if you find them or have them returned to you. You may be liable for unauthorized use of your card or Citibank

Classic checks, but not for more than $50. You won't be liable for any purchases or advances made after you've notified us of the loss or the theft by phone.

Stop Payment:

You may stop payment on a Citibank Classic check by notifying us in writing at P.O. Box 6500, Sioux Falls, South Dakota 57117 or by calling us at the telephone number listed on your monthly statement. If you call, you must confirm the call in writing within fourteen (14) days. A written stop payment order will remain in effect for six (6) months unless renewed in writing. We will charge a $15 fee when you stop payment on your Citibank Classic check.

Default:

You will be in default if you fail to pay the Minimum Amount Due listed on each monthly billing statement on time, file for bankruptcy, exceed your credit line without our permission, or default on this or any other agreement you have with us. If you are in default, we may close your account and demand immediate payment of the full balance. Don't let this happen. Call us first and let us try to help you.

Collection Costs:

If we have to refer collection of your account balance to a lawyer, you will pay our lawyer's fee plus court costs or any other fees as allowed by law. If we sue to collect and

you win, we will pay your reasonable legal fees and court costs.

Credit Reports:

We may report your performance under this Agreement to credit reporting agencies and secure follow-up credit reports on you, including if you fail to make your minimum payments on time. A bad credit report can significantly harm your ability to obtain credit from other sources. The information we will turn over to our credit reporting agencies will be your name, address, account and social security numbers, the status of your account, and any other information required by law. We will not turn over personal information, such as information relating to specific transactions on your account. Except for our affiliated Citicorp companies, no one else without proper legal authority will be given information about your account. We will try to notify you by phone or by mail of any legal process served on us in order to give you an opportunity to object to it, unless the law prohibits the notice.

Correcting Your Credit Report:

If you think we reported erroneous information about you to a credit reporting agency or wish to learn the names of the agencies we contacted, call us at the 800 number listed on your monthly billing statement. We will promptly investigate the matter; we will contact each credit reporting agency whose records may reflect the error; and we will require them to correct your report if our investigation shows you are right. If we disagree with

you after the investigation, we will tell you in writing or by phone and instruct you how to submit to those agencies a statement of your position that will become a part of your credit record with them. The instructions will include the name, address, and phone number of each such agency, along with other pertinent information.

Closing Your Account:

You may close your account at any time by notifying us in writing. However, you remain responsible to pay the amount you owe us according to the terms of this Agreement. We may close your account or suspend your card privileges or Citibank Classic checks at any time without prior notice. We may also reissue a different card or different checks at any time. You must return the card or the Citibank Classic checks to us upon request.

Changing This Agreement:

We can change this Agreement, including all fees and the annual percentage rate, at any time. However, if we do, we will mail you written notice at least 15 days before the beginning of the billing cycle in which the changes become effective. If you do not agree to the changes, you must notify us in writing within 25 days after the effective date of the changes and pay us the balance, either at once or under the terms of the unchanged Agreement. Otherwise, you will have agreed to the changes in the notice. Use of the card after the effective date of the change shall be deemed acceptance of the new terms, even if the 25 days have not expired.

Delay in Enforcement:

We can delay enforcing our rights under this Agreement without losing them.

Applicable Law:

The terms and enforcement of the Agreement shall be governed by South Dakota and federal law.

For Further Information:

Call us at the telephone number shown on the front of your monthly billing statement. You can also call toll-free information or local directory assistance to get our telephone number.

/s/ Ronald F. Williamson

Ronald F. Williamson	Citibank (South Dakota), N.A.
President & CEO	P.O. box 6000
May 1, 1992	Sioux Falls, SD 57117

What to Do if There's an Error in Your Bill.

Your Billing Rights.

Keep This Notice For Future Use.

This notice contains important information about your rights and our responsibilities under the Fair Credit Billing Act.

Notify Us in Case of Errors or Questions About Your Bill

If you think your bill is wrong, or if you need more information about a transaction on your bill, write to us (on a separate sheet) at the address shown on the front of your billing statement. Write to us as soon as possible. We must hear from you ***no later than 60 days*** after we sent you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information:

- Your name and account number
- The dollar amount of the suspected error
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are not sure about
- Please sign your letter.

Your Rights and Our Responsibilities After We Receive Your Written Notice

We must acknowledge your letter within 30 days, unless we have corrected the error by then. Within 90 days, we must either correct the error or explain why we believe the bill was correct. After we receive your letter, we cannot try to collect any amount you question, or report you as delinquent. We can continue to bill you for the amount you question, including finance charges, and we can apply any unpaid amount against your credit limit. You do not have to pay any questioned amount while we

are investigating, but you are still obligated to pay the parts of your bill that are not in question.

If we find that we made a mistake on your bill, you will not have to pay any finance charges related to any questioned amount. If we didn't make a mistake, you may have to pay finance charges, and you will have to make up any missed payments on the questioned amount. In either case, we will send you a statement of the amount you owe and the date it is due.

If you fail to pay the amount that we think you owe, we may report you as delinquent. However, if our explanation does not satisfy you and you write to us within 25 days telling us that you still refuse to pay, we must tell anyone we report you to that you have a question about your bill. And, we must tell you the name of anyone we reported you to. We must tell anyone we report you to that the matter has been settled between us when it is finally settled.

If we don't follow these rules, we cannot collect the first $50 of the questioned amount, even if your bill was correct.

Special Rule for Credit Card Purchases

If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services. There are two limitations on this right:

- You must have made the purchase in your home state or, if not within your home state, within 100 miles of your current address; and

- The purchase price must have been more than $50.

These limitations do not apply if we own or operate the merchant, or if we mailed you the advertisement for the property or services.

1992 Citibank (South Dakota) N.A.
BBC-SOL-NP 5/92

CITIBANK PREFERRED CARD AGREEMENT

This is your Citibank Preferred Card Agreement. Please read it and keep it for your records. You do not have to sign the Agreement. In the Agreement, the word *card* means either one or more cards; the words, *you, your* and *yours* mean the cardmember as well as anyone the cardmember permits to use the card; the words *we, us* and *our* mean Citibank (South Dakota), N.A. The words *Citibank Preferred checks* mean one or more checks that we may send to you to access your Citibank Preferred account.

Credit Line:

Your initial credit line will appear on the folder containing your card. A portion of your credit line will be available for cash advances. At our discretion we may change your credit line or cash advance limit at any time. We will notify you if we do, either by mail or through your monthly billing statement. You may request a change to your credit line or cash advance limit by contacting Citibank Customer Service by phone or mail.

Card Uses/Credit Line:

You must sign the card in order to use it. Your initial credit line will appear on the folder containing your card. This full amount is available to buy or lease goods or services wherever the card is honored. A portion of your credit line will also be available for cash advances (cash loans) at any bank or automated teller machine that

accepts the card or by using Citibank Classic checks. The total amount charged on your account, including purchases, cash advances, finance charges, fees, or other charges, must always remain below your credit line.

Additional Cards:

You may request additional cards on your account for yourself or others by contacting Citibank Customer Service. You are responsible for the use of each card according to the terms of this Agreement.

Annual Membership Fee:

You will pay us a non-refundable annual membership fee of $50. This fee will be added to your purchase balance on your first monthly billing statement and annually thereafter.

Billing:

We will send you a monthly billing statement when there is activity on your account. Your monthly statement will show your new balance, any finance charges, the minimum amount due, and the payment due date. In addition, it will show your current credit line and cash advance limit, an itemized list of current charges, Citibank Classic check transactions, payments and credits, a summary showing separately your purchase account, your cash advance account and finance charges on each, as well as other information concerning your account. You must notify us of a change in your address.

New Balance:

To determine your New Balance, we begin with the outstanding balance on your account at the beginning of each billing period – called the "Previous Balance" on your billing statement. We then add any purchases and cash advances that are recorded on your account and subtract any payments and credits received. We then add any other adjustments (for example, corrections of a prior calculation) and finally add the appropriate finance charges and fees.

Finance Charges on Purchases:

We will add a finance charge if you do not pay the New Balance listed on your last monthly statement in full on or before its payment due date. When you do not pay your New Balance in full (that is, if you choose to revolve), we will assess finance charges on purchases as follows.

- We start with the purchase balance at the beginning of your monthly billing period and will add to that any unpaid finance charges. This is called the "Previous Balance" on your statement. Your monthly billing period begins the day of your statement date and varies with the number of days in that billing month.

- On each day of the billing period we subtract payments, we add new purchases, and we make adjustments (e.g., for credited returns, prior statement errors, and the like). This determines the daily balance. Unless we elect to use a later date, we add purchases to the balance as of the date of the purchase.

■ We total the daily balances, and then divide that figure by the number of days in the billing period. This determines the average daily balance, which is the "balance subject to finance charge."

■ We multiply the "balance subject to **finance charge**" by 1.40%, the monthly periodic rate, which corresponds to a 16.8% **annual percentage rate.** This amount is your **finance charge** on purchases, unless (1) you qualify for a variable **annual percentage rate,** or (2) you default in meeting the requirements of any of your Citibank cardmember Agreements.

Variable Annual Percentage Rate/Qualifications:

■ You will qualify for an **annual percentage rate** that may vary each calendar quarter if: 1) you have been a cardmember for twelve (12) months or more; 2) the sum of your Preferred account purchases since you became a member is $3000 or more, or if you do not meet the purchase requirement, you have a combined balance of at least $3000 in your checking, savings, Insured Money Market Account or Certificate of Deposit Account with Citibank or a Citibank affiliate; and 3) you have kept all your Citibank credit card accounts in good standing by complying with your cardmember Agreements.

■ We will calculate the variable **annual percentage rate** by adding 7.4% to the rate disclosed as the U.S. Prime Rate reported in the "Money Rates" table of *The Wall Street Journal* on the third Tuesday of March, June, September, and December of each year. For example, because the U.S. Prime Rate was 6.5% on March 17, 1992, the applicable **annual percentage rate** would be 13.9%, which

corresponds to a monthly periodic rate of 1.1583%. If more than one such Prime Rate is published, we may choose the highest of such Prime Rates. In the event that *The Wall Street Journal* ceases to be published or ceases to publish the U.S. Prime Rate, we may refer to the Prime Rate published in any other newspaper of general circulation, or we may substitute a similar reference rate at our sole discretion.

■ Once you qualify, the variable **annual percentage rate** will take effect on all the new purchases you make from the first day of your billing period in which you qualify. As long as you continue to qualify, any increase or decrease in the variable **annual percentage rate** will take effect on the first day of your billing period directly following the month in which we calculate the rate. Each time the rate changes, it will be applied to the balance of all the purchases you have made from the first billing period in which you qualified. The **annual percentage rate** in effect and any subsequent changes to it will appear on your monthly billing statement. Balances on purchases made prior to the first billing period in which you qualified will continue to be subject to the 16.8% **annual percentage rate.** As long as you continue to qualify, the variable **annual percentage rate** will not be lower than 11.9% or higher than 16.8%.

■ If you default in meeting the requirements of this or any of your other Citibank credit card account Agreements, we will increase the **annual percentage rate** (whether the variable rate or the standard rate of 16.8%) on all your purchase balances (including all previous balances) to 19.8%, which corresponds to a monthly periodic rate of 1.65%. However, once all your accounts have

been in good standing for twelve (12) consecutive months, we will reevaluate your eligibility for the variable rate or the standard 16.8% **annual percentage rate.**

Finance Charges On Cash Advances:

We will add a finance charge for your cash advances from the day you take the cash advance until the day we receive payment in full. We determine the amount of the finance charge as follows:

■ We start with the cash advance balance at the beginning of your monthly billing period and will add to that any unpaid cash advance finance charges. This is called the "Previous Balance" on your statement.

■ On each day of the billing period we subtract payments, we credit adjustments, and we add new cash advances, other adjustments, and unpaid finance charges. This determines a daily balance. Unless we elect to use a later date, we add cash advances to the balance as of the day they are taken.

■ We total the daily balances, and then divide that figure by the number of days in the billing period. This determines the "balance subject to finance charge."

■ We multiply the "balance subject to **finance charge**" by 0.05424%, the daily periodic rate, which corresponds to a 19.8% **annual percentage rate**. We then multiply the resulting amount by the number of days in the billing period. This amount is your **finance charge** on cash advances.

Finance Charges – Cash Advance Transaction Fee:

We will also add an additional **finance charge** for each cash advance transaction. If you obtain the cash advance at an Automated Teller Machine (ATM), at a bank or other financial institution, or through the use of a Citibank Preferred check, the additional **finance charge** will be equal to 2% of the amount of each cash advance; however, it will not be less than $2.00 or more than $10.00. The cash advance transaction fee will cause the **Annual Percentage Rate** on your billing statement on which the transaction first appears to exceed the rate stated above.

Minimum Finance Charge:

If your finance charge for purchases or cash advances is less than 50¢, we will impose in each case a minimum **finance charge** of 50¢. We will charge the amount at our discretion to either your purchase or cash advance balance.

Charges Made in Foreign Currencies:

FOR VISA ACCOUNTS: If you incur a charge in a foreign currency, the charge will be converted by Visa International into a U.S. dollar amount. Visa International will use the procedures set forth in its Operating Regulations in effect at the time that the transaction is processed. Currently, those Regulations provide that the currency conversion rate to be used is either (1) a wholesale market rate or (2) a government-mandated rate in effect one day prior to the processing date, increased by one percent

in each case; Visa retains this one percent as compensation for performing the currency conversion service. The currency conversion rate in effect on the processing date may differ from the rate in effect on the transaction date or the posting date.

FOR MASTERCARD ACCOUNTS: If you incur a charge in a foreign currency, the charge will be converted by MasterCard International, Inc., into a U.S. dollar amount. MasterCard International will use the conversion procedures published from time-to-time to its members at the time that the transaction is processed. Currently, the currency conversion rate used to determine the transaction amount in U.S. dollars is either (1) a wholesale market rate or (2) a government-mandated rate in effect one day prior to the processing date, increased by one percent in each case; MasterCard retains this one percent as compensation for performing the currency conversion service. The currency conversion rate in effect on the processing date may differ from the rate in effect on the transaction date or the posting date

Minimum Amount Due:

The minimum payment will be the total of the following three items:

■ New Balance	Amount
• Less than $50	Total New Balance
• Between $50 and $1,800.................	$50 or the billed finance charge, if greater than $50.
• More than $1,800......	1/36th of your New Balance, rounded to the next whole dollar,

■ Any amount past due, and

■ Any amount in excess of your credit line.

You must pay at least the minimum payment each month, but you may pay more than that amount at any time without a penalty. The sooner you pay your New Balance, the less you will have to pay in finance charges.

Payments:

We can accept late or partial payments as well as payments that are marked "paid in full" or other restrictive endorsements, without losing any of our rights under this Agreement. If you pay more than the minimum amount due, we will allocate the excess amount to your purchase or cash advance balance at our discretion, unless you tell us otherwise. You must pay us in U.S. dollars drawn on funds on deposit in the United States. However, we reserve the right to accept payments made in Canadian currency. If we do, we will charge you a currency conversion fee based upon the "spot" rates existing at the time of conversion. Please do not send us cash payments.

Exceeding Your Credit Line:

We will charge your account an over the credit line fee of $10 for each billing period in which your New Balance exceeds your credit line This fee will be added to your purchase balance.

Late Payments:

Your purchase account will be charged a late payment fee of $6 if your minimum amount due is not received within 15 days after the payment due date. If we do not receive that minimum amount due by the next payment due date, your purchase account will be charged an additional late payment fee. This additional fee will be the greater of: 1) $15, or 2) 0.65% of your total New Balance (for your purchase and cash advance accounts) on your current statement, excluding this additional late payment fee. This additional late payment fee will continue to be assessed monthly until your account is less than 30 days past due.

Returned Payments:

We will charge your account a $15 fee if your check or similar payment instrument is not honored or if we must return it to you because it cannot be processed. This fee will be added to your purchase balance.

Cardmember Lists:

On occasion, we make our membership list available to selected companies whose products and services we hope will appeal to cardmembers like you. You may request that your name not be given to outside companies by writing to us at the address listed on your monthly bill or calling us via the 800# on your monthly statement. Please be sure to include your name, address and account number. Allow 8-10 weeks for your request to take effect.

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Stop Payment:

You may stop payment on a Citibank Preferred check by notifying us in writing at P.O. Box 6062, Sioux Falls, South Dakota 57117 or by calling us at the telephone number listed on your monthly statement. If you call, you must confirm the call in writing within fourteen (14) days. A written stop payment order will remain in effect for six (6) months unless renewed in writing. We will charge a $15 fee when you stop payment on your Citibank Preferred check.

Lost or Stolen Cards/Citibank Classic Checks:

If your card or Citibank Preferred checks are lost or stolen or if you are afraid someone used or may use them without your permission, you must notify us at once by calling the telephone number shown on your monthly statement or the number you get by calling toll-free information or your local Directory Assistance. We may require you to provide us certain information in writing to help us find out what happened. Don't use the card or the Citibank Preferred checks after you've notified us, even if you find them or have them returned to you. You may be liable for unauthorized use of your card or Citibank Preferred checks, but not for more than $50. You won't be liable for any purchases or advances made after you've notified us of the loss or the theft by phone or by writing at P.O. Box 6062, Sioux Falls, South Dakota 57117.

Default:

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If we have to refer collection of your account balance to a lawyer, you will pay our lawyer's fee plus court costs or any

other fees as allowed by law. If we sue to collect and you win, we will pay your reasonable legal fees and court costs.

Credit Reports:

We may report your performance under this Agreement to credit reporting agencies and secure follow-up credit reports on you, including if you fail to make your minimum payments on time. A bad credit report can significantly harm your ability to obtain credit from other sources. The information we will turn over to our credit reporting agencies will be your name, address, account and social security numbers, the status of your account, and any other information required by law. We will not turn over personal information, such as information relating to specific transactions on your account. Except for our affiliated companies, no one else without proper legal authority will be given information about your account. We will try to notify you by phone or by mail of any legal process served on us in order to give you an opportunity to object to it, unless the law prohibits the notice.

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Ronald F. Williamson	Citibank (South Dakota), N.A.
President & CEO	P.O. Box 6000
June 1, 1992	Sioux Falls, SD 57117

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In your letter, give us the following information:

■ Your name and account number

■ The dollar amount of the suspected error

■ Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are not sure about

■ · Please sign your letter

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We must acknowledge your letter within 30 days, unless we have corrected the error by then. Within 90 days, we must either correct the error or explain why we believe the bill was correct. After we receive your letter, we cannot try to collect any amount you question, or report you as delinquent. We can continue to bill you for the amount you question, including finance charges, and we can apply any unpaid amount against your credit limit. You do not have to pay any questioned amount while we

are investigating, but you are still obligated to pay the parts of your bill that are not in question.

If we find that we made a mistake on your bill, you will not have to pay any finance charges related to any questioned amount. If we didn't make a mistake, you may have to pay finance charges, and you will have to make up any missed payments on the questioned amount. In either case, we will send you a statement of the amount you owe and the date it is due

If you fail to pay the amount that we think you owe we may report you as delinquent. However, if our explanation does not satisfy you and you write to us within 25 days telling us that you still refuse to pay, we must tell anyone we report you to that you have a question about your bill. And, we must tell you the name of anyone we reported you to. We must tell anyone we report you to that the matter has been settled between us when it is finally settled.

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If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services. There are two limitations on this right:

- You must have made the purchase in your home state or, if not within your home state, within 100 miles of your current address; and
- The purchase price must have been more than $50.

These limitations do not apply if we own or operate the merchant, or if we mailed you the advertisement for the property or services.

PCA-VR 6/92

(5)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari
To The California Supreme Court

BRIEF FOR PETITIONER

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QUESTIONS PRESENTED

1. Did Congress intend South Dakota's legislative definition of "interest" to define the federal term "interest" in Section 30 of the National Bank Act, 12 U.S.C. § 85 ("§ 85"), and thereby displace other states' contract laws limiting the form or the amount of liquidated damages for late payments on revolving credit accounts?

2. May Congress constitutionally delegate to South Dakota the power to define the federal lending term "interest" for all fifty states so as to preempt other states' contract laws?

3. As a matter of federal law, does the term "interest at the rate" in § 85 include contingent, sum-certain penalty charges (late fees), so as to preempt state limitations on the form or the amount of contractual liquidated damages on revolving credit accounts?

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OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court (Pet. App. 1-72) are published at 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995). The majority and dissenting opinions of the California Court of Appeal (Pet. App. 74-98) are published at 26 Cal. App. 4th 1767, 32 Cal. Rptr. 2d 562 (1994). The opinion of the California Superior Court (Pet. App. 99-105) is unreported.

JURISDICTION

The California Supreme Court entered judgment on September 1, 1995. On November 30, 1995, petitioner invoked this Court's jurisdiction under 28 U.S.C. § 1257(a) by filing a Petition for a Writ of Certiorari to the California Supreme Court. This Court granted review on January 19, 1996. 116 S. Ct. 806 (1996).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved in this case are Article I, Section 1 of the United States Constitution (art. I, § 1); the Supremacy Clause (art. VI, cl.2); the Full Faith and Credit Clause (art. IV, § 1); Section 30 of the National Bank Act of 1864 ("§ 30"), Act of June 3, 1864, ch. 106, § 30, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. §§ 85 & 86 (1994)); S.D. Codified Laws Ann. §§ 54-3-1.1 and 54-3-1 (1990); and Cal. Civ. Code § 1671 (West 1995). The relevant portions of these provisions are reproduced at Appendix A to this brief, Pet. Br. App. A.

STATEMENT

This case involves the question of whether "federalism counts"[1] for national banks under section 85 (§ 85) of the National Bank Act ("the NBA"). A divided California Supreme Court held that § 85 employs a federal "choice of law provision" that entrusts the lawfulness of a national bank's loan-related charges to the bank's "home state and to its home state alone." (Pet. App. 30). According to the court's reasoning, the law of a bank's home state, in this case South Dakota, in effect defines the words "interest" and "rate" in the federal statute and determines the scope of federal preemption under § 85. Because relatively recent South Dakota legislation has defined late fees and other charges as "interest," *see* S.D. Codified Laws Ann. § 54-3-1 (1990), that legislation, as incorporated into § 85 by the lower court's construction, preempts even nondiscriminatory contract laws of a borrower's state that limit default penalties such as credit card late fees, over credit limit fees, return check fees and attorneys' fees. Petitioner challenges this overbroad interpretation of § 85 because Congress did not intend to preempt the contract laws of a borrower's state limiting single-sum penalties.

A. Statutory Context

Congress passed the NBA in 1864 against the backdrop of the Civil War. A year earlier, Congress had enacted the NBA's predecessor, the National Currency Act of 1863,[2] which provided the model for the 1864 statute. As with most legislation, the two acts were products of legislative compromise, although both were intended to provide for a uniform

[1] *See* Kenneth Starr, Patrick E. Higginbotham, *et al.*, The Law of Preemption, A Report of the Appellate Judges Conference 40 (American Bar Ass'n pamphlet 1991) ("The Law of Preemption").

[2] National Currency Act, ch. 58, 12 Stat. 665 (1863).

national currency that would facilitate financing for the war.[3] While some of the NBA's sponsors wanted to abolish all state banks and establish a national ceiling on interest rates, Congress opted instead to promote and protect privately owned national banks in a way that respected fundamental principles of federalism.[4]

Sensitive to broad intrusions on traditional areas of state control, Congress designed the NBA to prevent discrimination without displacing all state tort and contract laws as applied to the federally chartered banks. In fact, the earlier Currency Act respected local control by authorizing national banks to charge "such rate of interest . . . as is . . . the established rate of interest for delay in the payment of money . . . by the laws of the several States in which the associations are respectively located, and no more. . . . " 12 Stat. 678-79. One year later, despite vigorous attempts to establish a national interest rate ceiling,[5] Congress continued to respect state interests by enacting § 30 of the NBA, now codified as § 85 and 12 U.S.C. § 86 ("§ 86"). As originally enacted, § 30 authorized the national banks to choose from three rates of interest: the general statutory rate allowed by the state where the bank was

[3] *See, e.g.*, John J. Knox, A History of Banking in the United States 97-99, 227, 233, 238-266 (1908); Bray Hammond, *The North's Empty Purse, 1861-1862*, 67 Am. Hist. Rev. 1, 8-10 (1961) (noting that the NBA "was of far less help to the war than the war was of help to it.").

[4] *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1889-1900, 1952-57 and 2142 (1864) (reprinting the debate over whether states would be allowed under NBA section 41, 13 Stat. 111-112, to impose nondiscriminatory taxes on the shares of national banks as personal property of each of a bank's shareholders, and rejecting amendments that would have limited such state taxation despite pleas for nationalism and attacks on so-called "states rights" positions).

[5] *See, e.g.*, Knox, *supra* note 3, at 233 (noting that the Comptroller of the Currency recommended in his 1864 report that "the penalty for usury should be forfeiture of the interest instead of a forfeiture of the debt, and this uniform rate of interest should be seven percent."); Cong. Globe, 38th Cong., 1st Sess. 2123-2127 (debating and rejecting uniform rate ceiling).

located, a higher statutory rate if such a higher rate was allowed for state banks, or, if the state did not have a statutory interest rate ceiling, then a federal interest rate of "seven per centum," 13 Stat. 108. As with the Currency Act, the goal was to respect local control of interest rate ceilings while preventing state discrimination against national banks in favor of state lenders with respect to the allowed rates.

To protect the national banks from potentially hostile state usury statutes and penalties, Congress also provided uniform federal usury remedies. If an excessive rate of interest was charged but not paid by the borrower, the bank would be liable for forfeiture of the interest only, not the interest and the debt, which was the penalty in some states. *See Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 32-33, 36-37 (1875). If the excessive rate of interest was already paid, the bank would be subject to the federal penalty of double the amount of interest it had collected. *See id.* at 32. So, for interest rates, Congress gave notice to the states that while they could still control rates evenhandedly for all banks located within their borders, the statutory penalties for usury would be preempted as applied to national banks. This political compromise did not, of course, provide any notice to the states that their state contract or tort laws affecting bank loans would be preempted.

Congress enacted these intricate provisions intending the term "interest" to have a federal definition that would not depend on unique state definitions. *See Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 410 (1874) (holding that "interest" in § 85 must "receive a strict, that is literal construction" to avoid subjecting the banks to the penalty of double the interest collected). Although the numerical *rate* of interest could vary from state to state, the meaning and substantive components of "interest" for national banks would be the same throughout the country. In other words, § 85 incorporates only the rate ceilings of a bank's home state, not the states' varying definitions of "interest" or the divergent statutory elements and penalties for "usury." *See National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (explaining *Tiffany* and holding that only the "rate" of interest is federalized by § 85, not the character of the contracts banks are authorized to make).

Shortly after the NBA was passed, this Court recognized the Act's intricate design and addressed its preemptive scope. Although the newly chartered banks were federal instrumentalities, the Court emphasized that they were still subject to all state laws that did not directly conflict with federal law or "incapacitate[] the banks from discharging their duties to the government." *First Nat'l Bank v. Kentucky*, 76 U.S. (9 Wall.) 353, 362 (1870). In so holding, the Court observed that the banks "are governed in their daily course of business far more by the laws of the State than of the nation." *Id.* In addition, "their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts are all based on [and governed by] State law." *Id.* As a rule, the dealings and contracts of national banks are subject to general state laws except where there is an "express conflict" with federal laws, or the state laws frustrate the functions of the banks or impair "their efficiency to discharge the duties imposed upon them by the laws of the United States." *McClellan v. Chipman*, 164 U.S. 347, 357 (1896).

Congress's respect for federalist principles and local interests was tempered by its desire to ensure the success of the national banks. In *Tiffany*, this Court observed that § 85 bestows a most favored lender status on national banks. *See* 85 U.S. at 411-13. That status allows a national bank to charge the highest "rate" of "interest" allowed to any person (not just to state banks) by its home state. *Id.* at 413. In this way, national banks are "national favorites" because they enjoy greater interest rate authority than state banks in those states that limit the interest rates charged by state institutions. That most favored lender status is, of course, a product of § 85's language and design.

Years later, in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), the Court considered the meaning of the word "located" in § 85 and the preemptive scope of the section. Announcing what has become known as the "exportation" doctrine, the Court held that "located" has a firm, federal definition so that a national bank may "export" its home state's interest rate into other states. *See id.* at 310-14, 318. The Court ruled that a national bank located in Nebraska (the state identified in its federal charter) could charge the interest rate allowed by that state on loans to customers living in Minnesota, even though the Nebraska rate exceeded the statutory rate in Minnesota. *See id.* The Court did not, however, define the terms "interest" or "rate." Nor did it hold that the laws of a national bank's home state govern all the contractual terms or charges (other than "interest" as defined by Congress) imposed on consumers in other states.

Since *Marquette*, several small states (the "bank friendly states") and numerous banks have attempted to expand the "exportation" doctrine beyond the parameters established by this Court and Congress. During the 1980s, some of those states, most notably South Dakota, the current home of Citibank (South Dakota), N.A. ("Citibank" or "the bank"), and Delaware, sought to attract large credit card operations by deregulating banking and repealing consumer protection laws. *See* Federal Reserve Bank of Chicago, *Small States Teach a Big Banking Lesson*, Chicago Fed. Letter, No. 10 (June 1986). Recognizing that penalty fees represent a significant revenue opportunity that far exceeds any increased costs to issuers caused by late payments, the two states passed unique legislation that, contrary to the common law, redefined "interest" to include late fees, attorneys' fees and other contract terms and penalties. The idea was to allow national and other banks relocating to those states to "export" the terms and penalties into other states under the guise of "interest," a prospect that goes well beyond the holding in *Marquette* and the plain meaning of "interest at the rate" contained in § 85.

B. California Law

The California law involved in this case, Cal. Civ. Code § 1671, limits the charges all businesses, including banks, may impose on consumers for a breach of contract, such as a late payment. In contrast with the relatively recent legislation passed by bank friendly states like South Dakota and Delaware, California has followed the common law rule that compensatory "interest" is distinct from punitive contract penalties or forfeitures. For example, in *Beasley v. Wells Fargo Bank, N.A.*, 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446 (1991), *review denied*, 1992 Cal. LEXIS 1220 (Cal. Mar. 12, 1992), a case involving credit card late fees and overlimit fees, the California Court of Appeal recognized the ancient roots of this common law distinction. In describing the long-standing jurisdiction of equity courts over actions for relief from excessive liquidated damages, the court observed that "before 1697, the English courts of equity had exclusive jurisdiction to relieve a party from a penalty for breach of contract." *Id.* at 1391, 1 Cal. Rptr. 2d at 449, *citing* 2 Story, Commentaries on Equity Jurisprudence § 1301, at 536 (1836). The court further noted that under the Statute of William, passed by Parliament in 1697, a plaintiff in an action at law was limited to recovery of the actual damages for a breach of contract and could not recover any additional penalty provided for by the contract. *Id.* at 1392, 1 Cal. Rptr. 2d at 449.

This common law, the *Beasley* court found, was effectively codified in the 1872 predecessor to Cal. Civ. Code § 1671. Practically reflecting the current common and statutory law of liquidated damages, the 1872 legislation provided that a contractual predetermination of damages for breach of contract was void unless " 'it would be impracticable or extremely difficult to fix the actual damage.' " 235 Cal. App. 3d at 1398-99, 1 Cal. Rptr. 2d at 454 (quoting former § 1671). Thus, as the *Beasley* court held, current section 1671 "retains the former codified common law rule [of liquidated damages] for consumer actions." *Id.* at 1399, 1 Cal. Rptr. 2d at 454; *see Garrett v. Coast and Southern Fed. Sav. & Loan Ass'n*, 9 Cal.

3d 731, 739, 511 P.2d 1197, 1202 (1973) ("The fundamental difference between interest and penalty charges is that interest is a measure of compensation . . . while a penalty is punitive in character."). Important to the present case is the fact that this common law is separate and distinct from a statutory action for usury.

C. Factual Background

This case challenges the exportation of contract penalties as "interest" into states like California that limit or prohibit the contractual penalty provisions. From South Dakota, Citibank issues Visa cards and Mastercards to customers nationwide. (Pet. App. 110). Citibank charges these customers not only a hefty annual percentage rate but also a separate and additional $15 late charge if a specified minimum payment is not received within a number of days after the payment due date. In addition to Citibank's daily percentage rate finance charge, the bank charges the separate $15 late fee regardless of the outstanding balance, the amount of the payment owed, the actual number of days the payment is late, or the administrative costs associated with processing the late payments. (Pet. App. 114). Citibank's cardmember agreement treats the late payment as a technical breach of the contract and does not waive or forbear the default, even if the late fee is paid. (Pet. App. 117 & 122; *see* Jt. App. 49-82). Bearing no relationship to the amount owed, the passage of time or the bank's actual processing costs, and imposed in addition to continuing interest rate charges for delay, the late fee is a classic contract penalty. (Pet. App. 114-115).

Citibank charges its late fees in every state, including California, which indisputably regulates such charges as contractual liquidated damages or penalties, not as usurious interest. Here, Citibank exported its late fees into California and imposed them on Petitioner Barbara Smiley ("petitioner" or "cardholder") and other California residents. In response, petitioner filed this consumer class action on July 7, 1992, alleging that the late fees are excessive contract penalties

imposed in violation of California law. (Pet. App. 106-128). Since this litigation began, California has amended its laws to allow for the imposition of credit card late fees, but only in certain limited amounts. *See* Cal. Fin. Code § 4001 (West Supp. 1996). Under the lower court's holding, however, even those limitations also do not apply to out-of-state national banks because those banks are governed solely by the laws of their home states.

D. The Decision Below

Despite California's longstanding treatment of credit card late fees as common law contractual penalties, a 5-2 majority of the California Supreme Court upheld the dismissal of petitioner's complaint. According to the court, Congress has, in § 85, preempted all contract laws of a borrower's state that limit the loan-related fees of an out-of-state bank if the bank's home state has authorized the fees to be charged as "interest." (*See* Pet. App. 21-30). Since Citibank's late fees are considered "interest" under South Dakota's relatively recent legislation, the majority below concluded that California's liquidated damages law is preempted. (*Id.* at 39). In contrast, two dissenting justices reasoned that "interest" in the federal statute does not include the sum-certain contract penalties Citibank has exported into California. (*See id.* at 42 and 72). They would have ruled, as petitioner demonstrates below, that California's liquidated damages law is not preempted. (*See id.*).

SUMMARY OF ARGUMENT

This case will decide whether a bank's home state has boundless national lawmaking authority to preempt other states' contract, tort and consumer protection laws affecting credit cards held by consumers living in those other states. At stake is not only whether an out-of-state national bank can charge sum-certain late fees beyond the amounts allowed by the consumer's state, but also whether a consumer's state can

enforce other general contract, tort or consumer protection laws affecting bank loans issued by out-of-state banks. Eschewing a federal definition of "interest at the rate," the lower court construed the most favored lender principle of § 85 to encompass practically any loan-related term or charge. According to that court's reasoning, all laws of a borrower's state that have an indirect economic impact on the pricing of loans by national banks impermissibly intrude on the interest rates allowed by the bank's home state and must be preempted. Despite professing allegiance to this Court's precedents, both the lower court and respondent have disregarded the presumption against preemption and the "clear statement" rule. There is nothing in the text or the purposes of § 85 to support a finding that Congress enacted a boundless federal choice of law provision that empowers the home states of banks to establish lending laws for the entire nation.

The very context in which the NBA was passed establishes that Congress did not intend to enact a "federal choice of law" provision in § 85. Although the lower court emphasized the exigencies of the Civil War as proof of broad preemptive intent (*see* Pet. App. 24), the nature and causes of that vicious conflict actually prove the opposite. The Civil War Congress was acutely sensitive to broad intrusions on traditional state powers precisely because of that conflict. Given that sensitivity, Congress thoroughly debated and carefully crafted a banking act that generally respected state interests and displaced only those specific state laws that posed an actual threat to the success of the national banks. In other words, "federalism counts" in the NBA, as in all other statutes alleged to preempt state law.

To ensure that the political process has indeed considered the federal-state balance in making public policy decisions, this Court has employed a strong presumption against preemption. That presumption requires a "clear statement" of specific congressional intent before traditional state contract or tort laws are displaced. Neither indirect economic effects on, nor hypothetical interference with, the general subject

matter of a federal statute will suffice to preempt state law. If there is any doubt, state law must remain, for Congress retains the ultimate authority to broaden federal law and to make its intentions manifest.

The federal statute currently provides, in pertinent part:

> Any [national bank] may take, receive, reserve, and charge on any loan or discount made . . . , interest at the rate allowed by the laws of the State, . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper . . . , whichever may be greater, and no more. . . .

12 U.S.C. § 85. Section 85 thus regulates the "rate" of "interest" that can be charged by national banks. Like the word "located" construed in *Marquette*, the phrase "interest at the rate" in § 85 must have a federal definition. If not, the statute would unconstitutionally delegate unlimited federal lawmaking authority to the home states of banks.

Here, the lower court reversed the presumption against preemption. The court stated: "Had Congress intended to limit preemption, it would have doubtless made itself plain. It did not. Its silence is especially deafening." (Pet. App. 24). This notion – that when Congress intends *not* to preempt, it must specifically state that intention – is contrary both to this Court's precedents and to the federalist design of the NBA itself.

Section 85 does not use the words "relating to," "loan related" or "all credit terms." While the availability of certain contract terms or default penalties may have an indirect economic impact on the market rate of interest a bank might charge on a loan, the terms or penalties are not themselves interest rates within the meaning of § 85. The plain meaning of "interest at the rate" has always denoted a compensatory charge measurable by time and based on the unpaid balance. The late fees challenged here are not compensatory charges because they are sum-certain penalties imposed in addition to continuing interest rate finance charges. The late fees are

designed to punish and deter a technical breach of the loan contract, not to compensate the lender for delay.

The common law also has consistently distinguished between compensatory interest in the nature of damages for delay and contractual penalties for unliquidated costs, such as dunning letters or collection activities. Although contractual penalties were not limited under the statutory rules of usury, they were regulated under the contractual doctrine of liquidated damages. In finding the late fees here to be "interest," the lower court confounded these two distinct concepts. Again, there is no evidence Congress intended or even considered § 85 to obliterate the common law of liquidated damages.

Contrary to the lower court's assumption, this case is not about the wisdom of late fees or any other service charge on bank loans. The case is about the authority of a borrower's state to enforce evenhanded contract and tort laws of general application against out-of-state national banks soliciting business from consumers in the state. Different states may make different policy choices. But those choices should be respected absent a clear federal policy to the contrary. Apart from interest rate ceilings (usury laws), Congress has not addressed the public policy choices imbedded in state limitations on late fees, attorneys' fees or other default charges. When a court or even a bank's home state makes that policy choice by redrafting the text of a federal statute, Congress's national lawmaking authority has been subverted and the presumption against preemption nullified. For these reasons, "interest at the rate" in § 85 cannot be construed broadly to invalidate California's longstanding contract, tort and consumer protection laws limiting late fees.

ARGUMENT

I. FEDERALISM COUNTS IN SECTION 85 OF THE NATIONAL BANK ACT

The presumption against preemption is not a mere doctrinal curiosity. It has a constitutional foundation and rests on

fundamental "[p]rinciples of federalism." *Department of Revenue v. ACF Indus., Inc.*, 114 S. Ct. 843, 850-51 (1994). The Court has recognized that "the principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government itself." *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 550 (1985). The states *qua* states, and through their representatives in the central government, play a critical, if indirect, role in the crafting of federal legislation. James Madison explained that the federal government "will partake sufficiently of the spirit [of the States], to be disinclined to invade the rights of the individual States, or the prerogatives of their governments." The Federalist, No. 46 at 297 (James Madison) (Clinton Rossiter ed., 1961). Madison placed particular reliance on the equal representation of the states in the Senate, which he described as "at once a constitutional recognition of the portion of sovereignty remaining in the individual States, and an instrument for preserving that residuary sovereignty." The Federalist, No. 62 at 378 (James Madison) (Clinton Rossiter ed., 1961).

One of the vital "procedural safeguards inherent in the structure of the federal system," *Garcia*, 469 U.S. at 552, is the requirement of a crystal-clear statement of congressional intent before the states are stripped of the right to govern themselves and to protect their citizens against unfair, deceptive or unconscionable practices. *See California v. ARC America Corp.*, 490 U.S. 93, 101 (1989). Only a plain statement in the congressional legislation at the time the enactment is being debated can put the states on notice of the impending preemption of state law and enable the political safeguards of federalism to function. As the Court explained in *Gregory v. Ashcroft*, 501 U.S. 452 (1991), "inasmuch as this Court in *Garcia* has left primarily to the political process the protection of the States against intrusive exercises of Congress' Commerce Clause powers, we must be absolutely certain that Congress intended such an exercise. '[T]o give the state-

displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure for lawmaking on which *Garcia* relied to protect states' interests.' " *Id.* at 464 (quoting LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-25 at 480 (2d ed. 1988)); *see* THE LAW OF PREEMPTION *supra* p. 2, note 1, at 47 ("When courts consider whether Congress intended to preempt state laws, . . . the nations' commitment to federalism would seem to argue for an *especially clear* statement of congressional intent to oust states from their traditional legislative functions." (Emphasis added)).

Here, the lower court disregarded these principles and developed its own reverse federal preemption doctrine. Instead of interpreting § 85 narrowly in light of the NBA's context, it construed the statute broadly to implement the court's own conception of the most favored lender principle. The court failed to recognize, however, that that principle is itself confined by the federal meaning of "interest at the rate" in § 85.

This Court has emphasized that " 'the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the *clear and manifest purpose* of Congress.' "[6] *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (plurality opinion) (emphasis added) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). As a result, a "narrow reading" of the federal statute alleged to preempt state law is required. *See Cipollone*, 505 U.S. at 518.

Contrary to the constitutional underpinnings of the presumption against preemption, the lower court treated these standards as if they applied only to the "*existence*" of preemption under § 85, not to the *scope* of that preemption. (*See* Pet. App. 12 & 14). This Court has made clear, however, that the

[6] Consumer protection is an historic and important component of state police powers. *See Griffith v. Connecticut*, 218 U.S. 563, 568-69 (1910); *see also Aldens, Inc. v. Packel*, 524 F.2d 38, 43, 48-49 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

presumption applies equally to the *scope* and to the *existence* of preemption. *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1676-77 (1995); *Cipollone*, 505 U.S. at 518. Indeed, "[a]ny indulgence in construction should be in favor of the States, because Congress can speak with drastic clarity whenever it chooses to assure full federal authority, completely displacing the States." *Bethlehem Steel Co. v. New York State Labor Relations Bd.*, 330 U.S. 767, 780 (1947) (Frankfurter, J., dissenting); *see Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 275 (1943) (Congress is always free to make its intention clear and to expand federal law).

Applying these principles, the Court has required the party asserting preemption, in this case Citibank, to establish to a "certainty" that federal legislation specifically preempts state law. *See Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 255 (1984). To meet that heavy burden, Citibank was required to prove either express or implied preemption. Express preemption occurs when Congress specifically states that it intends to preempt state law. Implied preemption arises: 1) where Congress has so comprehensively ruled that supplementary state legislation is inappropriate; or 2) where state law directly conflicts with federal law or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See English v. General Elec. Co.*, 496 U.S. 72, 78-79 (1990); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Here, § 85 does not preempt state regulation of sum-certain contract penalties either expressly or by implication.

Relying on the "*existence*" of preemption identified in *Marquette*, the lower court in effect construed § 85 as expressly preempting state laws relating to loan charges. (*See* Pet. App. 36). Apart from its dubious interpretation of *Marquette*, the lower court failed to realize that § 85 does not use the words "relating to" or "loan-related charges." It uses, instead, the simple phrase "interest at the rate." That precise

phrase – unadorned with any broader descriptions – demonstrates that the statute does not, expressly or by implication, preempt anything other than a compensatory charge calculable as a "rate" based on time and the balance owed. As this Court has noted, the enactment of a provision defining the preemptive reach of a statute provides a reasonable inference that matters beyond that reach are not preempted. *See Freightliner Corp. v. Myrick*, 115 S. Ct. 1483, 1488 (1995); *Cipollone*, 505 U.S. at 517.

Far from establishing broad preemptive intent, the absence of the terms "relating to," "loan-related charges," or "all credit terms" actually establishes that § 85 does not reach the late fees involved in this case. As this Court has recognized, Congress, not the judiciary, is charged with amending federal statutes to clearly state a broad preemptive intent. *See Gregory*, 501 U.S. at 462-64. The decision below has usurped that power from Congress and turned the presumption against preemption on its head.

Reading the decision below as implicating implied preemption does not correct these defects. Congress has *not* sought to preempt all state regulation of banking. To the contrary, this Court's precedents firmly establish the absence of a comprehensive federal scheme. *See First Nat'l Bank v. Kentucky*, 76 U.S. at 362; *McClellan v. Chipman*, 164 U.S. at 347, 356-57; *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 248 (1944). Nor is there any direct conflict between the term "interest" in § 85 and California's law limiting sum-certain contractual penalties.[7]

California's regulation of penalty charges in no way prevents out-of-state banks from charging the unlimited interest rates that may be authorized by their home states, such as South Dakota. While the California liquidated damages law,

[7] To prove this type of implied conflict preemption, the bank must establish as a matter of fact an actual, not just a hypothetical, conflict between state and federal law. *See Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).

like its workers' compensation laws or even its zoning laws, may have an indirect economic bearing on the loan packages banks will offer in the state, it does not stand as an obstacle to the banks' doing business in the state or to the purposes of the NBA. *Cf. First Nat'l Bank v. Missouri*, 263 U.S. 640, 659 (1924) (state statute prohibiting branch banking does not frustrate or interfere with the purposes or the efficiency of national banks). In fact, banks located in California, though subject to the liquidated damages law, have not been impeded in performing their banking functions. *See, e.g., Beasley*, 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446.

Contrary to the presumption against preemption, and despite the absence of clear and manifest Congressional intent, the lower court, in effect, judicially redrafted § 85 to preempt more than its text directs. To be sure, § 85 is designed to prevent home-state discrimination against national banks with respect to interest rates. But that purpose does not convert the federal statute into a blanket override of sister state laws that might have an indirect economic impact on bank loan pricing or terms in those states. Indeed, in *Travelers*, 115 S. Ct. at 1671, this Court rejected such an indirect economic approach to preemption. Moreover, the NBA provides a substitute federal cause of action only for usurious rates of interest charged as consideration for a loan. *See* 12 U.S.C. § 86. It does not provide a claim for recovery of excessive contract penalties or a private right of action for challenges to unfair or deceptive banking practices. *Cf. Silkwood*, 464 U.S. at 255 (rejecting preemption of state law tort claims). Because the federal statute makes no mention of contract penalties, and because Congress has not even addressed the subject, § 85 does not preempt petitioner's California claims.

With the exception of state statutory or constitutional rate ceilings on "interest," as that term is defined by federal law, state law governs the contracts of national banks. *See First Nat'l Bank v. Kentucky*, 76 U.S. at 362. As long as the state law does not discriminate against the banks, it will apply. *See*

Anderson Nat'l Bank, 321 U.S. at 247-48 (NBA is intended to prevent discrimination against national banks, not to prohibit application of evenhanded state laws). In this case, California's law regulating both the forms and the amounts of contract penalties does not discriminate against national banks. It applies to all businesses equally.

Given the absence of a plain statement by Congress, Citibank cannot prove to a certainty, as it must, that the states and members of Congress were on notice that state contract laws limiting penalty charges or loan terms would be displaced by § 85 as laws either regulating interest or impacting economically upon interest rates. *See Gregory*, 501 U.S. at 464. Without a clear and definite statement of such broad preemptive purposes, the lower court could not have properly found preemption. As we detail below, there are no "clear statements" of such broad preemptive intent.

II. THE MEANING OF "INTEREST" IN § 85 SHOULD NOT BE DEFINED BY THE LAW OF THE BANK'S HOME STATE

A. The Most Favored Lender Principle Does Not Apply to the Package of Loan Terms

As a substitute for a clear statement, the lower court looked to the "most favored lender" principle. But that principle does not alter the plain meaning of "interest at the rate." Rather, the principle is itself confined by the plain meaning of § 85.

As noted, the legislative compromise that became § 85 respected federalist values while preventing discrimination against national banks. Congress's primary concern regarding interest rates was that a state might differentiate between lenders and set such a low rate that national banks could not profitably exist in that state. *See Tiffany*, 85 U.S. at 412-13. With the rejection of a uniform national rate, Congress decided to prevent discrimination by ensuring that national banks could charge the highest "*rate*" allowed in each home state. The "most favored lender" principle, announced in

Tiffany and discussed in *Marquette*, emanates from this design.

By focusing on the "rate of interest," not on the home-state's definition of the federal term "interest," the most favored lender principle allows a national bank to use its home state's *rate* to the extent that the *rate* conforms to the federal definition of "interest" in § 85. *See Evans v. National Bank*, 251 U.S. 108, 111 (1919) (NBA "adopts usury laws of the States only in so far as they severally fix the rate of interest"). Having its roots in the language of § 85 itself, the principle necessarily is limited by the federal meaning of the section. As explained in *National Bank v. Johnson*, the principle applies to the "rate of interest" alone and does not extend to all credit terms or credit charges:

> All that was said in that case [*Tiffany*] related to loans and to the rate of interest that was allowed thereon; and it was held that where by the laws of a State in which a national bank was located one rate of interest was lawful for natural persons and a different one to State banks, the national bank was authorized to charge on its loans the higher of the two. The sole particular in which national banks are placed on an equality with natural persons is as to the *rate* of interest, and not as to the character of contracts they are authorized to make; and that rate thus ascertained is made applicable both to loans and discounts, if there be any difference between them.

104 U.S. at 277 (emphasis in original). Accordingly, the most favored lender principle does not transform contingent charges for processing costs or deterrent penalties into "interest."

Contrary to these precedents, the lower court effectively construed the principle to embrace all loan-related fees. As recognized by the dissent below, however, a national bank's authority to impose single-sum penalty charges is not based

on § 85. (*See* Pet. App. 60-61 and 70-71).[8] Rather, section 24 of the NBA (formerly section 8, 13 Stat. 101) empowers banks "to make contracts" and exercise incidental banking powers. 12 U.S.C. § 24. Those incidental and contractual powers are governed by the basic tort, contract and other laws that are applicable to all lenders (indeed all businesses) conducting business *within a state*. Pursuant to these state laws, national banks can impose contractual terms to the same extent as other lenders (including natural persons) conducting business *in the state*. *See First Nat'l Bank v. National Exch. Bank*, 92 U.S. 122, 127 (1875) ("Banks may do, in this behalf, whatever natural persons could do under like circumstances."); *see also Perdue v. Crocker Nat'l Bank*, 38 Cal.3d 913, 938, 702 P.2d 503, 521 (1985) (12 U.S.C. § 24 does not preempt state law), *appeal dismissed*, 475 U.S. 1001 (1986). Of course, like other lenders, national banks are also bound by accepted conflicts of law principles and by the non-interest contract laws and public policies of other states. *Cf. First Nat'l Bank v. Kentucky*, 76 U.S. at 362 (banks are governed by general state law); *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 393-95 (1983) (each state may regulate areas of "legitimate local public interests" so long as burden on interstate commerce is evenhanded and not clearly excessive). Since these laws apply equally to all lenders, the NBA does not displace them or prevent their application to national banks. *See Davis v. Elmira Sav. Bank*, 161 U.S. 275, 290 (1896); *Anderson Nat'l Bank*, 321 U.S. at 247. In other words, only rates within the federal definition of

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[8] *See also Anderson Nat'l Bank*, 321 U.S. at 248; *McClellan*, 164 U.S. at 357. The majority below ignored *Anderson* and declined to follow *McClellan* because "a century of law, however, has intervened." (Pet. App. 12, n.4). But *McClellan* and *Anderson* remain good law and were binding on the lower court irrespective of perceived changed circumstances or the passage of time. *See Thurston Motor Lines, Inc. v. Jordon K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) (holding that lower court cannot disregard "old" Supreme Court precedent).

"interest" can be exported. For all other contractual terms, the states retain the power to enforce evenhanded restrictions that apply to both in-state and out-of-state lenders, including national banks.

The issue here is not whether Citibank can export "interest *rates*." Rather, the issue is whether it can also export contract penalties under the guise of "interest." The mere fact that a bank can impose certain contract terms and charges in its home state does not mean that all of those terms and charges are *federal* "interest." A contrary approach would have no logical stopping point, for South Dakota could define, as it has (*see* S.D. Codified Laws Ann. § 54-3-1, stating "including without limitation"), any loan-related term as "interest," and thereby preempt countless contract, tort and consumer credit laws of the other 49 states. *Cf. Healy v. Beer Institute*, 491 U.S. 324, 335-36 (1989) (extraterritorial application of state law causes "special concern . . . [as to] the autonomy of the individual States within their respective spheres.").

Relying on an expansive reading of the most favored lender principle, the court below concluded that "interest" must be interpreted broadly to achieve "uniformity and efficiency." (Pet. App. 29). But Congress rejected these goals when it refused to enact the national interest rate ceiling that the NBA's principal sponsors had advocated. *See* Cong. Globe, 38th Cong., 1st Sess. 1952-57, 2122-27. The lower court thus confused Congress's concern for discriminatory interest rate ceilings with a broader, unstated and unenacted intention to establish a federal choice of law provision. Nothing in the text or legislative history of the NBA either states or implies that Congress intended that broad preemptive purpose. Both the context in which the NBA was enacted and the status of national banks as federal instrumentalities indicate that if Congress had intended that purpose it would have said so specifically. Thus, the most favored lender principle is limited to the literal, federal meaning of "interest" and "rate."

That limitation makes sense here because Cal. Civ. Code § 1671 places absolutely no ceiling on the interest rates Citibank may charge pursuant to South Dakota law. The California law regulates only the form and procedure for setting contractual liquidated damages. Even if California law specified a maximum amount for sum-certain late fees, Citibank would still be allowed to charge the unlimited interest rate finance charges authorized by the South Dakota statute. As this Court recently noted in an analogous context, state law is not preempted merely because it might have an indirect economic impact on how a business may package its contractual charges or terms. *See Travelers*, 115 S. Ct. at 1677 ("If 'relate to' were taken to the furthest stretch of its indeterminacy, then for all practical purposes preemption would never run its course, for '[r]eally, universally, relations stop nowhere.' But that, of course, would be to read Congress's words of limitation as a mere sham, and to read the presumption against preemption out of the law whenever Congress speaks to the matter with generality." (Citation omitted)). Because California law does not regulate "interest," it does not conflict with § 85 or stand as an obstacle to the NBA.

B. A Limitless Home State or Administrative Definition Would Render § 85 Unconstitutional

When Congress enacts a statute, it ordinarily does not make application of the federal act dependent on state law. *Jerome v. United States*, 318 U.S. 101, 104 (1943). Moreover, when a federal statute is "[i]ntended to be nationwide in its application," its words should be given a federal meaning. *City of New York v. Feiring*, 313 U.S. 283, 285 (1941). These rules apply here and demonstrate that the term "interest at the rate" in § 85, like the word "located" construed in *Marquette*, has a federal meaning independent of unique state definitions.

In the § 85 case of *Haseltine v. Central Bank*, 183 U.S. 132 (1901), the Court concluded that "the definition of usury and the penalties affixed thereto must be determined by the National Banking Act, and not by the law of the State." *Id.* at

134. Similarly, in *Evans v. National Bank*, 251 U.S. 108, the Court recognized that both "interest" and "usury" were determined by reference to federal law, stating:

> The maximum interest rate allowed by the Georgia statute is eight per centum. That marks the limit which a national bank there located may charge upon discounts; but its right to retain so much arises from federal law. The latter also completely defines what constitutes the taking of usury by a national bank, *referring to the state law only to determine the maximum permitted rate*.

Id. at 114 (emphasis added). Similarly, in explaining *Tiffany*, the Court in *National Bank v. Johnson*, said that the most favored lender principle applies only "to the *rate* of interest, and not as to the character of [the bank's] contracts" 104 U.S. at 277 (emphasis in *Johnson*). So, contrary to the lower court's analysis, the definitions of a bank's home state are completely irrelevant to the meaning and the scope of the term "interest at the rate" in § 85.

If the rule were otherwise, "interest" and "rate" could have fifty different meanings provided by the fifty states. Each state could define "interest" however it wanted and could include attorneys' fees for collection, court costs, and countless other fees. This Court recognized the same danger in *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969), where it considered whether federal or state law defined the term "branch" in the NBA. Permitting state legislatures to define the federal term "branch," the Court stressed, would "make them the sole judges of their own powers," and that "Congress did not intend such an improbable result." *Id.* at 133-34; *cf. Seattle Trust & Sav. Bank v. Bank of California, N.A.*, 492 F.2d 48, 50-52 (9th Cir.) (noting that Congress could not have intended only a bank's home state to regulate all the bank's contracts), *cert. denied*, 419 U.S. 844 (1974).[9] Here, too,

[9] Courts, including the lower court, have misread other precedents such as *Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904); *Daggs v.*

Congress did not intend for South Dakota to preempt the consumer protection laws and common law of California simply by revising the federal definition of "interest" to include penalty charges. *Cf. Mississippi Band of Choctaw Indians v. Holyfield*, 490 U.S. 30, 44 (1989) (there is no reason to believe that Congress intended to rely on state law for the definition of a critical term in the statute).

Despite these precedents, the lower court found that Congress "has . . . entrusted the question of the lawfulness of a national bank's late payment fees to its home state and to its home state alone." (Pet. App. 30). According to that court, Congress also has entrusted all "usury" issues and "credit terms" to the lender's home state. (*See id.*). Petitioner submits that "entrusting" one state to determine the scope of federal preemption amounts to an unconstitutional delegation of legislative authority to that state.

It is a familiar principle that statutes are interpreted to avoid constitutional difficulties. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. and Constr. Trades Council*, 485 U.S. 568, 575 (1988). The lower court's construction of § 85, however, creates such difficulties because it causes the statute to be in violation of Article I, section 1 of the Constitution. That section provides that "[a]ll legislative Powers . . . *shall be vested in a Congress* of the United States." U.S. Const. Art I, § 1 (emphasis added). The lower court's interpretation of "interest" is actually a nondefinition that improperly vests

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Phoenix Nat'l Bank, 177 U.S. 549 (1900); *Union Nat'l Bank v. Louisville N.A. & C. Ry. Co.*, 163 U.S. 325 (1896); and *First Nat'l Bank v. Nowlin*, 509 F.2d 872 (8th Cir. 1975), as authority for § 85 incorporating all state law defining interest and usury. Properly understood, those cases do not conflict with *Haseltine*, *Evans*, *Johnson* and *Dickinson*. Instead, they merely adopt a state "*rate*" (or numerical ceiling) of interest, not the state's definition of the components of interest. Also, unlike here, none of the charges involved in those cases was a sum-certain penalty charge for a contractual breach. Finally, the *Nowlin* court improperly disregarded this Court's controlling decision in *Evans*. *See Thurston Motor Lines*, 460 U.S. at 535 (lower court may not disregard controlling precedent).

unlimited legislative power in a bank's home state, not in Congress.

Contrary to the lower court's "entrustment" analysis, Congress has never incorporated state law without limit into a federal statute so as to boundlessly preempt other states' laws. Instead, Congress has limited incorporation to precise areas in which the state standard would operate principally within the boundaries of the state itself, not in other states. *See, e.g., United States v. Sharpnack*, 355 U.S. 286 (1958) (addressing Assimilative Crimes Act of 1948, which adopted state law as the federal criminal law for military bases and federal enclaves located in each particular state).[10]

Obviously, the case at bar is not one in which the incorporation of South Dakota law affects only South Dakota. Allowing state law to define and redefine "interest" in § 85 leads to the absurd and unconstitutional result that Congress has authorized South Dakota to legislate federal lending terms for the whole country. "To vest the power of determining the extraterritorial effect of a State's own laws and judgments in the State itself risks the very kind of parochial entrenchment on the interests of other States that it was the purpose of the Full Faith and Credit Clause and other provisions of Art. IV of the Constitution to prevent." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

In striking down a federal statute that effectively delegated interstate commerce powers to the individual states (and to the President), this Court has emphasized the necessity of federal guidelines limiting the delegated authority:

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[10] The lower court, relying on *Sharpnack*, stated that Congress "has not made a delegation." (Pet. App. 30). If the § 85 term "interest at the rate" were narrowly and correctly defined by federal law, petitioner would agree. But the court made its definition dependent on state, not federal, law. The court thus apparently saw a distinction between "entrusting the question of the lawfulness of a lending charge" to a state and "delegating" the question of the lawfulness to a state. There is no such distinction in logic or in language, nor can there be.

> [The statute] does not seek to lay down rules for the guidance of state Legislatures or state officers. It leaves to the states and to their constituted authorities the determination of what production shall be permitted. It does not qualify the President's authority. . . . It establishes no criterion to govern the President's course. It does not require any finding by the President as a condition of his action.

Panama Refining Co. v. Ryan, 293 U.S 388, 415 (1935). Expanding on these principles, the Court has since identified three important functions of the nondelegation doctrine. One, the doctrine ensures that important choices of social policy are made by Congress, not by unrepresentative entities that are unresponsive to the popular will of the nation. *See Industrial Union Dep't v. American Petroleum Inst.*, 448 U.S. 607, 685 (1980) (Rehnquist, J., concurring); *see also Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 151-52 (1963) (construing a federal statute so as not to preempt a California law and thereby avoiding a difficult issue of whether Congress improperly delegated its authority). Two, it provides Congress's delegatee with an "intelligible principle" to guide the exercise of the delegated discretion. *Industrial Union*, 448 U.S. at 685-86. And, three, it "ensures that courts charged with reviewing the exercise of delegated legislative discretion will be able to test that exercise against ascertainable standards." *Id.* at 686.

Here, delegation to South Dakota of the legislative power to define, either directly or indirectly, the federal term "interest" fails on all three counts. The decision whether "interest" includes liquidated damages, attorneys' fees, court costs or other contractual penalties is "quintessentially one of legislative policy" that should be made by Congress, not by an individual state legislature that is unaccountable to the will of the nation. *See id.* Furthermore, neither the word "interest" nor the legislative history of the NBA provides any guidance as to the scope of the word or the limits of the delegated discretion. Indeed, as construed by the lower court, the most favored lender principle means that a bank's home state can

define anything to be "interest." Because, under the lower court's interpretation, Congress has provided no definition, established no standard, laid down no rule and declared no policy separate from that of the individual states, the delegation or "entrustment" inferred by the lower court is unconstitutional. *See Panama Refining*, 293 U.S. at 421, 430 ("The Congress manifestly is not permitted to abdicate, or to transfer to others, the essential legislative functions with which it is thus vested"); *Industrial Union*, 448 U.S. at 646 (plurality opinion) (construing statute so as to avoid open-ended delegation of legislative power).[11]

The Office of the Comptroller of the Currency's ("OCC") administrative definition of "interest," issued on the eve of argument in this case without an express Congressional delegation of preemptive authority, does not fare any better. In § 86, Congress expressly established the Judiciary, not the OCC, as the adjudicator of private rights of action arising under §§ 85 and 86. As the Court has held in similar circumstances, "a precondition to deference . . . is a congressional delegation of administrative authority." *Adams Fruit Co. v.*

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[11] Although *Marquette* has, in effect, permitted a bank's home state to establish "interest rates" that are controlling in other states, that result is not a forbidden abdication of Congress's lawmaking authority. Adoption of a state's time-based rate or required charge for a loan is in fact bounded and checked by a federal definition of "interest at the rate" that is limited to compensation for a loan of money for a stipulated time. *Cf. Bowsher v. Synar*, 478 U.S. 714, 732 (1986) (indicating that delegation of "essentially ministerial and mechanical" power is constitutional). That definition provides definite federal standards to determine whether a home state's "rate" comports with the will of Congress or exceeds Congress's intent. If, in contrast, South Dakota has been "entrusted" to expand the meaning of "interest" and "rate" so as to determine what credit terms are lawful, as the lower court held, then Congress has delegated to that state national lawmaking authority and Supremacy Clause powers. Allowing South Dakota to set not just a time-based rate required for a loan but also to define the actual rights and liabilities of credit cardholders (*e.g.*, what "late" means? whether attorneys' fees are collectible?), subverts the entire structure of federalism.

Barrett, 494 U.S. 638, 649 (1990). Here, as in *Adams Fruit*, Congress has not delegated to the bank's regulator any authority to expand, contract or define the scope of §§ 85 and 86. Because the statute provides both a uniform remedy and a private right of action, only the courts have that interpretive authority.

Moreover, even if the OCC was entitled to some deference because of its administration of the NBA, as this Court has instructed, far less deference is appropriate when the agency's interpretations have been inconsistent. *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987). *Accord Sherman v. Citibank (South Dakota), N.A.*, 143 N.J. 35, 668 A.2d 1036, 1047 (1995), *petition for cert. pending*, No. 95-991 (U.S. filed Dec. 21, 1995). Here, the OCC has issued contradictory, unauthorized and eleventh hour definitions of "interest" that lack both a reasoned analysis and a rational explanation for its complete reversal in policy. Although the lower court presumably declined to defer to the OCC's interpretations because of the inconsistencies, it nonetheless noted its agreement with the agency's current policy. That agreement was equally incorrect.

In 1964, the Comptroller of the Currency issued an advisory bank letter that addressed the meaning of "interest" in § 85 and opined that "*[c]harges for late payments* . . . are illustrations of charges which are made by some banks which *would not properly be characterized as interest*." OCC Letter, James Saxon, Comptroller of the Currency (June 25, 1964) (emphasis added). (Pet. Br. App. B, reprinting OCC letter). For the next twenty-four (24) years, the Comptroller's 1964 interpretation remained the view of the OCC regarding late fees. However, in 1988, the OCC staff took a different approach. In an informal opinion letter, the OCC's Deputy Chief Counsel concluded that "interest" in § 85 is defined by the law of a bank's home state, and if the state definition includes late fees or even attorneys' fees, then "interest" in § 85 will include late fees and attorneys' fees. *See* OCC Letter No. 452, R. Serino, Deputy Chief Counsel, *reprinted in* [1988-1989 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 85,676 at 78,064 (Aug. 11, 1988). Taking yet another

approach in 1995, the OCC Chief Counsel wrote that federal law, not state law, provides the definition of "interest" in § 85, and that under federal law, "interest" includes all expenses and charges related to a loan. *See* OCC Letter No. 676, J. Williams, Chief Counsel, *reprinted in* [1994-1995 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 83,618 (Feb. 17, 1995).[12] These conflicting analyses, among others,[13] demonstrate that the OCC's views have vacillated so dramatically and capriciously that they do not warrant any deference. *See Sherman*, 143 N.J. at ___, 668 A.2d at 1047. Thus, "interest at the rate" in § 85 must have a federal definition determined not

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[12] This letter violated the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 114, 108 Stat. 2238, 2366 (codified at 12 U.S.C. § 43 (1994)). That statute, entitled "Notice Requirements For Banking Agency Decisions Preempting State Law," makes it clear that the OCC cannot issue an opinion concluding that state law is preempted unless it first follows certain stringent publication procedures. *See* 12 U.S.C. § 43. The OCC did not follow those procedures in issuing the Williams letter. *See* H.R. Conf. Rep. No. 651, 103d Cong., 2d Sess. 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2039, 2068-74 (criticizing bank regulators for issuing overly aggressive interpretations preempting state law).

[13] In direct response to this and related litigation, the OCC, on March 3, 1995, issued a notice of a proposed interpretive rulemaking. *See* 60 Fed. Reg. 11924, 11929 (1995) (to be codified at 12 C.F.R. § 7.4001) (proposed Mar. 3, 1995). The notice proposed to interpret "interest" in § 85 over 100 years after the fact to include late fees and thereby preempt state laws limiting such penalties. On February 9, 1996, the OCC issued a "final" version of the proposed interpretation with an "effective date" of April 1, 1996. *See* 61 Fed. Reg. 4849-4870 (1996) (noting that the interpretation constitutes a "significant change" in OCC policy). Both the notice and the final version lack any reasoned explanation for the OCC's inconsistent and contradictory positions. The curious timing of the OCC's proposals, combined with the agency's inconsistent analyses, raises the specter of manipulation of pending litigation that this Court has decried as an "administrative shell game." *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223, 2227 (1994).

by administrative fiat but by judicial canons of statutory construction.

III. AS A MATTER OF FEDERAL LAW, "INTEREST AT THE RATE" MUST RELATE TO THE TIME-VALUE OF MONEY

The lower court misapplied settled rules of statutory construction and confused two distinct concepts when it treated the late fees in this case as "interest." Interest may include three types of charges: (i) periodic percentage rates; (ii) definite up-front charges that can be amortized over a loan term for a per year rate (such as discounts or mortgage points); and (iii) interest in the nature of delay damages that are based on an unpaid balance and measured by time. The lower court equated the late fees here with interest in the nature of delay damages. But Citibank's late fees are not compensatory or based on time and the balance owed. The late fees are an entirely different type of charge.

The contingent sum-certain late fees are contract penalties, not interest in the nature of damages. As this Court has recognized in related contexts, the distinction between a "penalty as a fixed *ad valorem* amount taking no account of time, and interest which does depend on time, is persuasive." *Meilink v. Unemployment Reserves Comm'n*, 314 U.S. 564, 570 (1942). The difference is that "[a] penalty is a means of punishment; interest a means of compensation." *United States v. Childs*, 266 U.S. 304, 309 (1924). Longstanding common law has even treated excessive contract penalties as being against public policy and unenforceable. *See Tayloe v. Sandiford*, 20 U.S. 13, 18, 7 Wheat. 7, 9 (1822) (refusing to enforce contract penalties); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 226 (1930) ("But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced"). So the question in this case is whether § 85 has so clearly obliterated the common law distinction between interest in the nature of

damages and sum-certain penalties that California's contract laws are preempted. The answer to that question is no.

A. The Plain Meaning of "Interest" Excludes Penalty Charges.

As the lower court recognized, § 85's impact on the common law of contract penalties depends on the breadth of the words "interest" and "rate" in the statute. But the statute does not define either "interest" or "rate." The starting point, then, is the plain meaning of the words. *See Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 194 (1985). This Court has stressed that the plain meaning of legislation should be conclusive, except in "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989) (observing that "interest" is distinct from "fees, costs, or charges"). Here, the literal definitions of "interest" and "rate" are consistent with Congress's intention in the NBA.

First, modern authorities define "interest" and "rate" as having compensatory characteristics related to the time-value of money. *See, e.g.*, WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 630 (1989) ("interest" is "a charge for borrowed money[,] generally[14] a percentage of the amount borrowed"); BLACK'S LAW DICTIONARY 730 (5th ed. 1979) ("[t]he percentage of an amount of money which is paid for its use for a

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[14] While "generally" does not mean always, it does reflect the commonly understood or "plain meaning." *See Mazaika v. Bank One, Columbus, N.A.*, 439 Pa. Super. 95, 106-07, 653 A.2d 640, 646 (1994) (*en banc*), *alloc. granted*, 659 A.2d 557 (Pa. 1995); *Copeland v. MBNA America, N.A.*, 820 F. Supp. 537, 540 (D. Colo. 1993). Still, petitioner does not contend that interest must always be stated as a percentage amount. Nor does petitioner insist that penalties can never be a percentage amount. Rather, whether a charge constitutes a penalty or interest depends on whether it bears some relationship to the contractual time-value of money and the amount of the debt. If the charge, as here, bears no such relationship, it is a penalty, not interest.

specified time"). In *Deputy v. DuPont*, 308 U.S. 488 (1940), this Court defined "interest" as "*compensation for the use or forbearance of money*," and stated that "[i]n the absence of clear evidence to the contrary, we assume that Congress has used these words in that sense." *Id.* at 498 (footnote omitted, emphasis added). Here, there is no evidence Congress intended "interest" to mean extra processing charges or penalties imposed in addition to daily finance charges accruing on the entire balance, particularly when there is no forbearance by the lender.

Second, this plain definition of a time-based compensatory charge prevailed when the NBA was enacted. According to the dictionaries of that day, "interest" was a "sum of money paid or allowed for the loan or use of some sum, lent for a certain time, according to a fixed rate." WHARTON'S LAW LEXICON 391 (2d ed. 1860). *See also* 2 ALEXANDER M. BURRILL, A NEW LAW DICTIONARY AND GLOSSARY 629 (1851) (same); JACOB'S LAW DICTIONARY (10th ed. 1797) ("The legal profit or recompense allowed, on loans of money, to be taken from the borrower by the lender"). "Interest" was also defined as "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use." 1 JOHN BOUVIER, A LAW DICTIONARY 652 (7th ed. 1857). *See also* MARK ORD, LAW OF USURY 29 (3d ed. 1809) ("Interest may be defined to be a certain profit, which the lender is to have for the use of the loan"); PERLEY, PRINCIPLES OF THE LAW OF INTEREST 1 (1893) ("The word *interest* is derived from the latin words, *inter*, between, and *esse*, to be; and has reference to the time between the receiving and the paying back the money for which period only interest is allowed").

Thus, current and historical definitions of "interest" all denote an element of time-based compensation. Sum-certain contingent penalties simply do not satisfy these plain meaning characteristics. As sum-certain charges, late fees are not "compensation" for the time-value of money because they do not vary based on the payment owed or the time period of

delay. They also are not risk-based. Moreover, the fees are imposed in addition to daily accruing percentage interest charges. Although they might reflect a minor element of cost recovery for dunning letters or administrative processing, the late fees are primarily deterrent or punitive charges for a contractual breach. (*See* Pet. App. 114-115). They are, in fact, contract penalties.

On at least three occasions before passage of the NBA, this Court had identified the common law differences between contract penalties, like late fees, and damages in the nature of interest. In *Tayloe v. Sandiford*, the Court stated that "[i]n general, a sum of money, in gross, to be paid for the nonperformance of an agreement is considered as a penalty." 20 U.S. at 17, 7 Wheat. at 8. Later, in *Lloyd v. Scott*, 29 U.S. 205, 4 Pet. 173 (1830), the Court held:

> If a party agree [sic] to pay a specific sum exceeding the lawful interest, provided he do [sic] not pay the principal by a day certain, it is not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, *which is considered as a penalty.*

Id. at 226, 4 Pet. at 190 (emphasis added). Likewise, just one year before enactment of the NBA, the Court stated with respect to any contingent charge:

> The payment of anything additional depends also upon a contingency, and not upon any happening of a certain event, which of itself would be deemed insufficient to make a loan usurious.

Spain v. Hamilton's Adm'r, 68 U.S. (1 Wall.) 604, 626 (1863).[15]

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[15] In the 1800s, as now, liquidated damages for the costs and expenses incident to a default were regulated not by the statutory rules of "interest" or "usury" but by the contract rules of reasonableness as to penalties. *See, e.g.*, GEORGE SHARSWOOD, POPULAR LECTURES ON COMMERCIAL LAW 30-31 (1856) (agreement to pay costs and expenses incident to default would not be regarded as "interest" or "usury"); *Daly v.*

By commercial and common law standards, therefore, it was clear in 1864 that contingent sum-certain penalties were different from post-default damages measured by an interest rate related to time and the balance owed. "[W]here words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country, they are *presumed* to have been used in that sense unless the context compels to the contrary." *Lorillard v. Pons*, 434 U.S. 575, 583 (1978) (emphasis added, citation omitted). Here, even the context of the language demonstrates that Congress understood "interest" to mean compensation related to the time-value of money.

The term "rate" appears in § 85 at least ten times, and it always refers to a charge that is related to the passage of time. By contrast, § 86 of the NBA provides that, where an excessive rate has been charged, the borrower may recover a penalty equal to twice the interest paid. Unlike the compensatory "rate" language in § 85, the language in § 86 refers to a sum-certain penalty that is totally unrelated to the passage of time. *See First Nat'l Bank v. Morgan*, 132 U.S. 141, 144 (1889) (§ 86 case recognizing a material difference between compensatory "interest" and deterrent or punitive "penalties"). Congress thus knew the difference between compensatory interest "rate" charges based on the passage of time and punitive sum-certain penalties that are unrelated to the time-value of money. Without doubt, the context of § 85 also permits a national bank to charge interest at the highest "rate" allowed to any lender in its home state. *See Tiffany*, 85 U.S. at 411-13. But that context does not limit or even address the

Maitland, 88 Pa. 384, 386 (1879) (Sharswood, C.J.) (contractual agreement to pay commission for collection distinguishable from that of a penalty, which was distinguished yet again from interest); ROBERT B. COMYN, TREATISE ON THE LAW OF USURY 73-74 & n.(a) (R. Pheney, London 1817) (charges for costs are considered "*nomine poenae*" that are "relievable against in equity"). *See also Sun Printing & Publishing Ass'n v. Moore*, 183 U.S. 642, 660-670 (1902) (describing general common law of liquidated damages).

incidental or contractual power of a bank under 12 U.S.C. § 24 to impose late fees or other types of contract terms separate from a compensatory "rate." In short, the plain meaning of "interest at the rate" in § 85 does not reach or preempt the state law penalty claims asserted in this case.

B. The Common Law Definition of "Interest" Excludes Penalty Charges.

Under federal law, it is also a "settled principle of statutory construction that, absent contrary indications, Congress intends to adopt the common law definitions of statutory terms." *United States v. Shabini*, 115 S. Ct. 382, 384 (1994). In fact, there is a strong presumption favoring a common law meaning for words used in a federal statute. This Court recently described that presumption in *United States v. Texas*, 507 U.S. 529 (1993), a case that also dealt with the meaning of "interest" in a federal statute. There, the Court instructed:

> [s]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles. . . . In such cases, Congress does not write upon a clean slate . . . . In order to abrogate a common law principle, the statute must "speak directly" to the question addressed by the common law.

Id. at 534 (citations and internal quotation marks omitted).[16] The Court also distinguished between interest and late fees and found that late fees are "more onerous than the common law" of prejudgment interest. *See id.* at 536 ("Unlike the

[16] Here, the California Supreme Court failed to follow the "long-established" common law meaning of interest identified in *United States v. Texas*. Instead of looking to the common law, it construed "interest" based on the recent legislative definition of Citibank's home state. But the lower court's reliance on South Dakota's special statute was improper. Since § 85 does not " 'speak directly' to the question addressed by the common law," it does not abrogate the common law. 507 U.S. at 534. South Dakota's redefinition of the federal term "interest" also cannot abrogate that common law.

common law, § 3717 also imposes processing fees [for late payments] and penalty charges"). Since late fees are "more onerous than the common law" of interest, they cannot be one and the same as interest.

Cases contrasting usury, the charging of excessive interest, with contingent collection fees further demonstrate this point. *See Merchants' Nat'l Bank v. Sevier*, 14 F. 662, 663, 667 (C.C.E.D. Ark. 1882) (surveying the common law of penalties and the statutory principles of usury). In *Sevier*, an NBA case decided just eighteen years after passage of the Act, a federal circuit court held that a provision in a note imposing collection costs after a loan default was "a stipulation for a penalty or forfeiture [under the common law] . . . and void." *Id.* at 663. The *Sevier* court directly considered the power of national banks to impose post-default collection costs, like attorneys' fees and late fees. Relying on this Court's § 85 decision in *National Bank v. Johnson*, 104 U.S. at 277, the court rejected the argument that a national bank could charge collection costs as "interest." 14 F. at 665.[17] The very fact that courts reviewing bank penalties

[17] The collection fees in *Sevier*, like the late fees here, were post-default costs assessed in amounts unrelated to time or the amount of the unpaid loan. Also, *Sevier* did not depend on a state law definition of "interest," because it was decided under the regime of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 18-19 (1841), which established the rule that federal law provides the content of terms implicating general commercial matters. *See* 14 F. at 665-75. *Sevier* further holds that while unfair collection costs could not be charged as "interest" by a bank, reasonable costs could be imposed *within* a bank's home state as a matter of contract law. *See id.* at 667 (Circuit Judge concurring). Since such costs are not interest, each state can limit those costs and thus prohibit both in-state and out-of-state banks from charging excessive contingent fees for a contractual breach. Moreover, while the court below purported to distinguish *Sevier* on the facile ground that the collection costs were labeled attorneys' fees, even attorneys' fees would be "interest" under that court's broad definition of the term. Contrary to the lower court's analysis, the *substance* of the charge, *not the form* should control. Whether labeled a collection fee, a late fee or any attorneys' fee, the issue is whether the charge is measurable by time and

shortly after the NBA recognized the difference between sum-certain default charges and interest, as did the *Sevier* court, demonstrates that § 85 does not abrogate the common law of contract penalties.

Here, as in *Sevier*, the late fees are penalties that may or may not be incurred depending solely on the borrower's conduct. From the start, a late fee is not required for a loan, so a lender has no way of knowing whether or not a late fee will ever be charged. In contrast, a lender committing usury seeks to evade statutory limits on the permissible interest rate by controlling, from the outset, the classification of interest and other charges that will in fact be imposed. Although contingent collection fees imposed because of a contractual breach were *not* regulated as usurious interest, they were limited under the common law of liquidated damages and penalties. *See United States v. Childs*, 266 U.S. at 307; *Sun Printing & Publishing Ass'n v. Moore*, 183 U.S. 642, 660-669 (1902).[18] There is no indication that Congress intended by ambiguity or silence to depart from this longstanding common law when it used the words "interest" and "rate" in § 85.

based on the unpaid balance, so that it is a compensatory rate rather than a punitive forfeiture.

[18] *See also* George W. Field, The Law of Damages §§ 22, 134-56 (1876); Charles T. McCormick, Handbook on the Law of Damages §§ 146-157 (1935); II Samuel Williston, Contracts §§ 769-792 (1920); 5 Samuel Williston, Contracts § 780 (3d ed. 1961); 5 Arthur L. Corbin, Contracts § 1058 (1964); 1 Theodore Sedgwick, Measure of Damages §§ 389-427 (9th ed. 1912); 1 Joseph A. Joyce, Treatise on Damages §§ 1, 2, 33 (1903); 2 *id.* §§ 1333-34; Restatement of Contracts § 339 (1932); U.C.C. § 2-718 (1957). Although certain annotations have attempted to rationalize various state usury laws, they are off-point because they concentrate on post-default "rate" increases, not on sum-certain penalties. *See, e.g.*, Annot. *Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious*, 82 A.L.R. 1213, 1214-23 (1933). Besides, they entirely ignore the distinct common law of penalties. *See United States v. Texas*, 507 U.S. at 534.

Other critical differences between interest and late fees become obvious in the context of delay damages, or prejudgment interest. Delay damages accrue at a particular rate of interest over time and are based on the amount of the debt outstanding. *See United States v. Texas*, 507 U.S. at 536 (describing the common law); *Library of Congress v. Shaw*, 478 U.S. 310, 322 n.7 (1986) (adjustments for the time of payment are made with interest or a delay factor, but not both). The sum-certain late fees here, however, do not depend on an interest rate, the passage of time, or the amount outstanding.

In contrast with "interest," the late fees here are special charges that more than compensate the lender for delay. *See Kothe*, 280 U.S. at 226. In the past, this Court has observed that special charges beyond those for delay were not allowed. In *Loudon v. Taxing Dist.*, 104 U.S. (14 Otto) 771 (1881), for example, the borrower defaulted, requiring the lender to sell his own assets at a substantial discount. After the lender sued for the "costs" of the default, the issue was whether the borrower was liable for more than the time-value of the lender's money. This Court held that interest measured by time was the *only* delay damage allowed:

> *all damages for delay* in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

Id. at 774 (emphasis added). *See also New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (a party "cannot recover special damages for the detention of money due to him beyond what the law allows as interest"). The ruling below has turned the reasoning of *Loudon* and *Piaggio* upside down and allowed duplicative recovery for a contractual breach. Instead of "interest" based on the unpaid balance and measured by time being "the measure of all such damages," the lower court incorrectly concluded that special, sum-certain penalties also are a measure of delay damages.

The bank's late fees here, like the special charges in *Loudon* and *Piaggio*, do not merely compensate the bank for the contractual time-value of money since they are imposed – in addition to continuing interest charges – primarily to enhance revenues and deter or punish a technical breach. The bank does not condition its loans on the payment of such penalties, nor does it forebear on the contractual defaults that precipitate the charges. Instead of being time-based compensation for the use or forbearance of money, the fees are additional *contingent* charges that do not fluctuate based on any increased risk. Indeed, the basic fees remain static regardless of whether a late payment is $20 or $200 or one day or thirty days late. Thus, the lower court confused the common law distinctions between damages in the nature of interest and special contractual penalties for unliquidated and purported additional processing costs. These common law differences are highlighted by the fact that South Dakota itself deemed it necessary to statutorily redefine "interest" to include such penalty charges in § 54-3-1. Obviously, there would be no need for such a statute if the plain, common law meaning of "interest" had always encompassed these charges.[19]

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[19] Around the time the NBA was passed, most state common law also defined "interest" as the compensation paid by the borrower for the use of the lender's money measured over time. *See Davis v. Rider*, 53 Ill. (53 Freeman) 416, 417 (1870). *See also Kelsey v. Murphy*, 30 Pa. (6 Casey) 340, 341 (1858) ("Interest has been defined to be a compensation allowed to the creditor for delay of payment by the debtor."); *Gaar v. Louisville Banking Co.*, 74 Ken. (11 Bush) 180, 189 (1874) ("Interest is the premium allowed by law for the use of money."). Thus, the components of an interest rate were the amount charged, the amount loaned, and the time involved. Although a few states, such as South Dakota, have recently, by statute, expanded the definition of interest, the basic common law definition has not changed. *See United States v. Texas*, 507 U.S. at 536.

C. The NBA's Legislative History Also Demonstrates That "Interest" Does Not Include Contract Penalties.

As noted, Congress first enacted §§ 85 and 86 in § 30 of the NBA. The predecessor to § 30, section 46 of the National Currency Act, also focused on a time-based *rate* by referring to "interest for delay in the payment of money." 12 Stat. 678-79. Although this phrase was omitted from § 30 a year later, there is no dispute that Congress intended "interest at the rate" to mean compensation "for the delay in the payment of money." In fact, shortly after passage of § 30, this Court held that "[i]nterest is given on money demands *as damages for delay in payment*, being just compensation to the plaintiff for a default on the part of his debtor." *Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) (emphasis added). Thus, the time period of delay was always an important feature of "damages in the nature of interest" in the 1800s.

The debates of the 38th Congress likewise confirm that "interest at the rate" in § 85 includes only detention damages that are based on an unpaid balance and measured by time. In deciding whether to set a national ceiling on interest rates, various members of Congress observed that interest rate ceilings varied from state to state. In each and every debate, the members referred to "interest" as a charge measured over time for the use of money. *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (Rep. Cole of California: "In California, the interest is by law, where no rate is expressed in the contract, ten percent per annum"); Cong. Globe, 38th Cong., 1st Sess. 1374 (Rep. Kasson of Iowa: "In my own State, sir, we allow a rate of interest of ten percent per annum."); Cong. Globe, 38th Cong., 1st Sess. 2122-24 (where several Congressmen recognize the differences in state statutory interest "rate" ceilings). Congress thus considered interest "rate" ceilings (usury laws) to be affirmative legislative actions taken to regulate time-based charges for a loan.

In the legislative compromise that became § 85, Congress undoubtedly considered these interest "rate" ceilings to be

matters of state legislative policy. But Congress did not intend for the states to change the existing common law definitions or principles in order to broaden the preemptive scope of the NBA. *See* Cong. Globe., 38th Cong., 1st Sess. 1952-57, 2122-24 (debate over the role of the states). On the contrary, Congress rejected a uniform national interest rate ceiling in order to respect state control and the interests of federalism. *See id.* Besides, the common law of contract penalties, unlike state statutes, applied equally to all businesses and did not discriminate against banks by setting an interest rate ceiling. *See Lloyd v. Scott*, 29 U.S. at 226, 4 Pet. at 190; *United States v. Texas*, 507 U.S. at 536. Because there was no need to alter or even address the common law, Congress borrowed and preempted only the statutory "*interest rate*" ceilings of the states. Hence, § 85, as enacted in 1864, or as subsequently amended,[20] does not plainly state a broader intention to

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[20] In 1974, Congress temporarily amended § 85 and the Federal Deposit Insurance Act to allow national banks and other lenders to charge interest on certain business and agricultural loans at a rate of 5% above the federal discount rate where the bank was located. Act of Oct. 29, 1974, Pub. L. No. 93-501, §§ 201-206, 88 Stat. 1557, 1558-60. In that law, Congress first used the preamble language: "In order to prevent discrimination against . . . banks with respect to interest rates." *Id.* Because the amendment was a temporary law directed at the unique statutory or constitutional usury limits in just three states (Arkansas, Montana and Tennessee), Congress emphasized that it was *not* "overriding [all] state law in this area, *especially with respect to consumer and home mortgage loans*." S. Rep. No. 1120, 93d Cong., 2d Sess. 18 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6249, 6261 (emphasis added). As with other common law states, the usury laws of Arkansas, Montana and Tennessee did not apply to contingent charges (late fees) within a borrower's control. *See, e.g., Hayes v. First Nat'l Bank*, 256 Ark. 328, 507 S.W.2d 701, 703 (1974); *Wilson v. Dealy*, 222 Tenn. 196, 201, 434 S.W. 2d 835, 837 (1968). Therefore, the 1974 Congress never intended to and did not preempt the late fee limitations in those states. Nor did Congress intend the preamble language concerning "discrimination . . . against banks" to apply to or preempt evenhanded contract or consumer laws limiting contract penalties, like late fees.

federalize and preempt the distinct common law limiting penalties or forfeitures for a breach of contract.

D. Congress and Federal Regulators Have Repeatedly Defined "Interest" to Exclude Contract Penalties.

In 1933, Congress amended § 85 to permit national banks to charge an alternative federal interest rate of one (1) percent over the discount rate on ninety day commercial paper. *See* 12 U.S.C. § 85. Discount interest (which is collected or charged at the outset of a loan) has never included contingent default charges, like late fees, which may never even arise. (*See* Pet. Br. App. C, reprinting OCC letter describing "discount rate"). In the amendment, the term "discount rate" was added to the same sentence as the phrase "interest at the rate," indicating that the latter should be construed no more broadly than the former. Indeed, this Court has emphasized that important statutory terms should be construed consistently with other terms with which they are associated. *See Gustafson v. Alloyd Co.*, 115 S. Ct. 1061, 1069-70 (1995); *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). This rule is particularly apt here, because Congress could not have intended the two alternative rates made available by § 85 to be measured differently so that they could not be compared to one another. After all, if banks were to make an intelligent choice between the discount rate alternative and their home state rate, the two rates would have to include or exclude the same things. Otherwise, the banks could not possibly know which rate was higher. Because discount interest does not include contingent penalties like late fees, loan "interest" must also exclude such charges.

Congress's use of the term "interest" in other laws regulating banks is also instructive. In the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 132-193 (1980) (codified in scattered sections of 12 U.S.C.), Congress preempted state laws limiting "interest rates" and "other charges *for* a loan"

but not state laws limiting contract penalties like late fees. In the legislative history accompanying DIDA, Congress explained that "*The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.*" S. REP. No. 368, 96th CONG., 1st SESS. 19 (1979), *reprinted in* 1980 U.S.C.C.A.N. 236, 255 (emphasis added).[21] Congress therefore again recognized the longstanding differences between penalties and "interest rates" and intended to displace only state interest "rate" ceilings.

DIDA also shows that Congress, as in 1864, was primarily concerned with only the affirmative legislative usury ceilings of the states, not with the common law of contract penalties. For example, DIDA § 521 preempts "State constitution[s] or statute[s]," but makes no mention of the common law. 12 U.S.C. § 1831d. This Court, in *Cipollone*, explained that a federal statute which expressly preempts "any state statute or regulation" may only preempt state legislation and will not generally preempt state common law. 505 U.S. at

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[21] Congress intended this legislative history to apply to every section of DIDA, not just to mortgage loans. When Congress first considered DIDA in 1979, it initially focused only on business and mortgage loans and temporarily enacted as a stop-gap just two sections (sections 501 and 511) of the law. *See* Act of Dec. 28, 1979, Pub. L. No. 96-161, 93 Stat. 1233-35; H.R. CONF. REP. No. 842, 96th CONG., 2d SESS. 69, 78 (1980), *reprinted in* 1980 U.S.C.C.A.N. 298, 308. Afterwards, in early 1980, Congress revisited those two sections as well as additional sections covering other types of loans. *See* 1980 U.S.C.C.A.N. at 308. At the time, Congress had before it the two Senate Reports, Nos. 96-368 (Oct. 15, 1979) and 96-73 (Apr. 24, 1979) which described the precise preemptive scope of DIDA. Congress therefore had the interpretation of the Senate Reports at its disposal when it reenacted the two temporary sections together with the added sections in 1980 and "did nothing to disapprove of [the] plain meaning reading" of interest as it applied to all sections of DIDA. *Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907, 913 (3d Cir. 1990).

522-23.[22] The same is true for § 85 because that statute is the model on which § 521 was based. The fact that Congress, in enacting § 521, used language expressly limiting preemption to state statutes or constitutions evidences Congress's belief that § 85 likewise has the same limited preemptive effect. *Cf. In re Asbestos Litigation*, 829 F.2d 1233, 1238 (3d Cir. 1987) (observing that under regime of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 18 (1841), the phrase "laws of the several states" was interpreted narrowly to include only statutory enactments), *cert. denied*, 485 U.S. 1029 (1988). Like § 521, § 85 preempts only state legislative ceilings on interest rates. It does not preempt traditional common law and public policy limits on penalties for unliquidated processing costs or to punish a contractual breach.[23]

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[22] The Court in *Cipollone* considered the preemptive effect of a federal statute that expressly preempted the "requirements or prohibitions . . . imposed under [s]tate law." The Court compared this statute with an earlier proposed version that had preempted "any state statute or regulation." Finding that the earlier version had preempted only positive enactments of state law, the Court found that the final version preempting "[s]tate law" was not so narrow. 505 U.S. at 523. Thus, the Court implicitly recognized that federal statutes expressly preempting state statutes may not reach state common law.

[23] Unless "interest" is defined as meaning only time-based compensation for a loan of money (and not a sum-certain penalty for a borrower-induced default), other sections of the federal banking laws cannot make sense. For example, under 12 U.S.C. § 347b(a) (1994), "interest" is "a rate equal to the lowest discount rate in effect at such Federal Reserve Bank on the date of such notice." Since a discount rate by definition cannot include a default charge (which may never even arise), interest must also exclude such default charges. Also, pursuant to 12 U.S.C. §§ 371a and 371b, "interest" is the amount that a bank pays on demand deposits and savings deposits. Obviously, a bank cannot pay late fees on savings or demand deposits. *See also* Rev. Rul. 72-315, 1972-1 C.B. 49, 50 ("a 'service charge' is a fixed charge having no relationship to the amount borrowed or the time given to pay whereas interest is based on the amount deferred and the time of deferral"); 12 C.F.R. § 217.2(d) (1995) (Federal Reserve Board defines interest to include "any payment to or for the

E. Single-Sum Late Fees Do Not Embody the Essential Characteristics of Interest.

Despite the overwhelming body of law establishing that single-sum late fees and other contract penalties are not interest, some courts construing § 85, including the court below, have erroneously held otherwise. These courts, glossing over the bulk of the controlling precedent, have jumped on the bandwagon propelled by the wrongly decided case of *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993). The *Greenwood* court concluded that DIDA § 521 preempts a Massachusetts consumer protection law prohibiting credit card late fees.[24] In so holding, the court misread a number of the authorities on which it relied and failed to recognize the undeniable differences between contingent penalties for a contractual breach and interest as damages for delay.

For example, as support for the conclusion that single-sum late fees may be interest, both the court below and the *Greenwood* court cited the non-§ 85 and non-NBA cases of *Shoemaker v. United States*, 147 U.S. 282 (1893), and *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177 (1873). Both of those cases are off-point, however, because they involve delay damages

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account of any depositor as compensation for the use of funds" but not expenses incident to a bank's normal function or service charges); 12 C.F.R. §§ 226.4(b)(1) and (c)(2) (Federal Reserve Board defines "late charge" as entirely different from the broad term "finance charge," which includes interest, in the Truth-in-Lending Act); 1980 U.S.C.C.A.N. at 255 (equating loan interest in DIDA with deposit interest).

[24] The court in *Greenwood* completely disregarded the strong presumption against preemption recognized in *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981), and many other cases. The *Greenwood* court recognized that the term "interest" was "susceptible to interpretation – not that the Commonwealth's interpretation . . . [was] necessarily wrong or that the appellant's interpretation [was] necessarily correct." 971 F.2d at 828. The court also found that DIDA's text and legislative history were "inconclusive." *Id.* Yet, despite the ambiguity, the *Greenwood* court found preemption.

(*i.e.*, prejudgment interest charges measured by time and the balance owed to compensate for delay), not penalties for a contractual default. In *Shoemaker*, this Court recognized that interest "accrues." 147 U.S. at 321. Similarly, in *Brown*, the Court held that time-based damages did not accumulate ("run") during the Civil War when the obligation to repay the principal of a loan was suspended. 82 U.S. at 185-86.

The single-sum late fees here, in contrast, cannot "run" or "accrue" and are not measured by time. In fact, this Court's more recent decision in *United States v. Texas*, 507 U.S. at 536, explains the relevant principles of delay damages (prejudgment interest) that were only touched upon briefly in *Shoemaker* and *Brown*. Given that *United States v. Texas* holds that late fees are not part of the common law of prejudgment interest, *Shoemaker* and *Brown* cannot stand for the erroneous proposition that penalty charges are interest.

Both the *Greenwood* court and the lower court further assumed that any lender imposed fee could constitute interest. But the cases cited by the court do not stand for that boundless principle. As the New Jersey Supreme Court observed in *Sherman*, 143 N.J. at ___, 668 A.2d at 1044-46, the authorities relied upon by *Greenwood* simply do not indicate that single-sum late fees are interest.[25]

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[25] Under the Federal Reserve Board's definitions for the Truth-in-Lending Act, 15 U.S.C. § 1601 (1994), it is readily apparent that the cases cited in *Greenwood* are entirely different from the present case. The charge in *American Timber and Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982), involving compensating balance requirements, would constitute a "finance charge" under 12 C.F.R. § 226.4(b)(5) (1995). The cash advance fee in *Fisher v. First Nat'l Bank*, 548 F.2d 255, 258-61 (8th Cir. 1977), would constitute a transaction "finance charge" under 12 C.F.R. § 226.4(b)(2). The bonus or commission in *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.), *cert. denied*, 290 U.S. 685 (1933), would be a finder's fee "finance charge" within the meaning of 12 C.F.R. § 226.4(b)(3). As noted, a late fee is not a "finance charge," because it is not "interest" compensation for the use of money. *See* 12 C.F.R. § 226.4(c).

Until *Greenwood* and its progeny, the plain meaning of "interest" was a compensatory rate based on the amount of the unpaid loan, measurable over time or required up-front as consideration for the loan. Despite the more than 150 years of case law recognizing these characteristics, *Greenwood* and the decision below do not even mention them. Nor do they address the substantial body of liquidated damages law that would not exist but for the differences between single-sum late fees and interest.

F. "Interest" In § 85 Must Be Interpreted Narrowly.

This Court has long held that because a violation of § 85 subjects a national bank to the § 86 penalty of forfeiture of double the interest collected, the statute must "receive a strict, that is literal construction." *Tiffany*, 85 U.S. at 410. Indeed, a national bank "is not to be subjected to a penalty unless the words of the statute plainly impose it." *Id.*; *see Keppel v. Tiffen Sav. Bank*, 197 U.S. 356, 362 (1905). Thus, to avoid subjecting the fledgling national banks to the severe penalty for usury, Congress must have intended "interest at the rate" to be construed narrowly. Otherwise, the banks would be exposed to usury claims any time a separate fee caused the interest rate to exceed the statutory ceiling. Congress did not intend that result. Congress instead intended a plain federal meaning for "interest at the rate" that does not include the sum-certain late fees exported by Citibank into California in this case.

G. As A Matter Of Public Policy, "Interest" In § 85 Does Not Preempt State Laws Limiting Contract Penalties

At the petition stage, Citibank professed reliance on informal federal regulatory opinions and projected imminent doom should this Court uphold the presumption against preemption in this case. Those proclamations, however, have been directed to the wrong forum and are beyond the record in this case. It is Congress's role, not the Court's or the

regulators', to rewrite legislation to address the bank's policy concerns. *See Gregory*, 501 U.S. at 460. As this Court has stated, "any plea to alter § 85 . . . is better addressed to the wisdom of Congress." *Marquette*, 439 U.S. at 319. Moreover, the bank's reliance arguments are misplaced. The federal law applicable to a particular case does not turn on whether litigants actually relied on an administrative rule. *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510, 2516 n.9 (1993).

Citibank further insisted below that prohibiting single-sum late fees will require credit card issuers to raise periodic percentage interest rates, which will purportedly restrict the availability of credit to high risk borrowers. Those unsupported contentions miss the point, however. The importance of our federalist system lies in the ability of each state to make its own policy decisions for its own citizens in the absence of clear Congressional intent to the contrary. Here, California has balanced consumer rights and business interests differently than has South Dakota. Congress has not itself directly addressed the subject. Besides, since this case was dismissed at the pleadings stage, there is absolutely no credible economic evidence in the record to support the assertion that permitting late fees increases the number of consumers who can qualify for a credit card. If, however, the Court looks beyond the record, it should focus on the fact that Citibank has obtained an unfair economic advantage over the many other out-of-state card issuers who have complied with the California law limiting late fees and other penalties.

In sum, the *in terrorem* pleas and economic reliance arguments of the bank disregard the legitimate legislative choices made by California. That state limits contractual penalties as a matter of public policy to prevent further oppression of a party with unequal bargaining power who may already be at an economic disadvantage and may lack any alternative but to pay the penalty. California's public policy decision is the prerogative of the California legislature. While Citibank may disagree with that public policy decision, it cannot point to any contrary decision by Congress. Citibank's

plea that this Court judicially amend § 85 to create an *ad hoc* federal policy is misdirected. "For if in close or uncertain cases a court proceeds to preempt state laws where that result was not clearly the product of Congress' considered judgment, the court has eroded the dual system of government that ensures our liberties, representation, diversity, and effective governance." THE LAW OF PREEMPTION, *supra* p. 2, note 1, at 47.

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be reversed.

Dated: March 1, 1996

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APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, section 1 of the United States Constitution directs, in pertinent part, that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. art. I, § 1.

The Supremacy Clause provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Full Faith and Credit Clause requires, in pertinent part, that "Full Faith and Credit shall be given in each State to the public Acts, Records, and Judicial Proceedings of every other State." U.S. Const. art. IV, § 1.

Section 30 of the National Bank Act, as codified at 12 U.S.C. § 85, provides, in pertinent part:

> Any [national bank] may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located,

> whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under state laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. . . .

12 U.S.C. § 85 (1994).

Prior to codification, Section 30 of the National Bank Act also provided what is now codified, in pertinent part, in 12 U.S.C. § 86:

> The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action on debt, twice the amount of the interest thus paid. . . .

12 U.S.C. § 86 (1994).

The California Civil Code section 1671 states, in pertinent part:

> (b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

> (c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:
>
> (1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or
>
> (2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.
>
> (d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

Cal. Civ. Code § 1671 (West 1985)

Section 54-3-1 of the South Dakota Codified Laws states as follows:

> Interest is the compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation, points, loan origination fees, credit service or carrying charges, charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit. These charges do not include charges made by a third party.

S.D. Codified Laws Ann. § 54-3-1 (1990).

Section 54-3-1.1 of the South Dakota Codified Laws states, in relevant part, that:

> Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement

S.D. Codified Laws Ann. § 54-3-1.1 (1990).

APPENDIX B

JUN 25 1964

In your letter of May 22, 1964, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each question transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be please [sic] to furnish such information upon request.

Sincerely,

(Signed) James J. Saxon
James J. Saxon
Comptroller of the Currency

APPENDIX C

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219
Jul 01, 1980

Dear Mr. ________

This is in response to your letter of April 14, 1980, in which you ask for an interpretation of 12 U.S.C. § 85, in light of the 3% surcharge which the Federal Reserve Banks have recently imposed on loans to certain institutions.

Section 85 allows national banks to charge interest on loans "at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located. . . . " Unlike § 511(a) of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, which allows national banks to charge on certain loans "5 per centum in excess of the discount rate, *including any surcharge thereon*" (emphasis added), § 85 makes no mention of the surcharge. Instead, it looks only to the discount rate itself. Furthermore, §§ 521, 522, 523, and 524 of DIDA, which extend the Federal Reserve discount rate option to other financial institutions, similarly make no mention of the surcharge. Thus, interpreting 12 U.S.C. § 85's discount rate as including the surcharge would make the above-quoted language in § 511(a) of DIDA unnecessary.

It is therefore my opinion that "discount rate," as employed in 12 U.S.C. § 85, refers only to the base discount rate, and not to any surcharge imposed by the Federal Reserve Banks, whether or not a particular bank is paying that surcharge. It should, however, be noted that this conclusion is also based upon the nature of the recently imposed surcharge, *i.e.*, the fact that it was not imposed upon all member banks. My conclusion may differ if, at some future time, the Federal Reserve Banks impose a "surcharge" on loans to all member banks.

I trust that this has been responsive to your inquiry.

Very truly yours,

John E. Shockey
Chief Counsel

(13)

No. [illegible]

FILED
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CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On a Writ of Certiorari to the
California Supreme Court

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Of the three questions listed by petitioner, the only one actually presented in this case is the third, which respondent would suggest rephrasing as follows:

> Does the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, include charges by a national bank for the failure of a borrower to make timely payment of amounts due on credit card accounts?

Petitioner's first two questions are not presented. The California Supreme Court did not hold, and no party contends, that the South Dakota legislature has the power to define the term "interest" as used in section 85 of the National Bank Act. *See* discussion *infra* p. 14 n.5.

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The opinion of the California Supreme Court is reported as *Smiley v. Citibank (South Dakota), N.A.*, 900 P.2d 690 (1995) (Petitioner Appendix ("P.A.") 1-72). The opinion of the Court of Appeal appears at *Smiley v. Citibank (South Dakota), N.A.*, 26 Cal. App. 4th 1767, 1770, 32 Cal. Rptr. 2d 562, 564, *review granted*, 883 P.2d 387 (Cal. 1994) (P.A. 74-98). The order and opinion of the trial court (P.A. 99-105) are not reported.

JURISDICTION

The California Supreme Court entered its judgment on September 1, 1995. The petition was filed and docketed on November 30, 1995, and this Court granted review on January 19, 1996. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved in this case are the Supremacy Clause, U.S. Const. Art. VI, cl. 2; section 85 of the National Bank Act, 12 U.S.C. § 85; section 86 of the National Bank Act, 12 U.S.C. § 86; section 54-3-1 of the South Dakota Codified Laws; section 54-3-1.1 of the South Dakota Codified Laws; and section 1671 of the California Civil Code. Section 85 is set forth in full in Appendix A to this brief (Respondent's Appendix ("R. App.") A). All remaining constitutional and statutory provisions are set out, in relevant part, in Appendix A to the Brief for Petitioner ("Br. App. A").

STATEMENT

The question in this case is whether the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, covers flat-rate late-payment charges such as those specified in two credit card agreements between petitioner and respondent.[1]

---

[1] In addition to the California Supreme Court, two other state supreme courts and two U.S. courts of appeals have addressed the

A. Statutory Background

Section 85 of the National Bank Act, provides, in pertinent part, as follows:

> [a]ny [national banking] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located . . . .

12 U.S.C. § 85.

Citibank (South Dakota), N.A. ("Citibank") is a national bank, chartered by the Office of the Comptroller of the Currency (the "OCC") pursuant to the National

same legal issue. All except the New Jersey Supreme Court have answered the question "yes." *See Spellman v. Meridian Bank*, No. 94-3203, 1995 WL 764548, *18 (3d Cir. Dec. 29, 1995) ("over-credit limit fees and late fees constitute interest, because they provide mechanisms to compensate the lender for the increased lending risk associated with people who incur these kinds of charges"), *as amended by* 1996 WL 20762 (3d Cir. Jan. 12, 1996), *rehearing en banc granted on banks' motion, opinion vacated* (Feb. 16, 1996); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 830-31 (1st Cir. 1992) (both section 85 and section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") pre-empt Massachusetts law prohibiting late charges), *cert. denied*, 113 S. Ct. 974 (1993); *Copeland v. MBNA Am. Bank*, 907 P.2d 87, 91 (Colo. 1995) (late-payment fees imposed on credit card accounts are "interest" under section 85), *pet. for cert. filed*, 64 U.S.L.W. 3469 (Dec. 28, 1995) (No. 95-1056); *Stoorman v. Greenwood Trust Co.*, 908 P.2d 133 (Colo. 1995) (affirming dismissal of plaintiff's complaint, also under Colorado law, as pre-empted by section 521 of DIDA), *pet. for cert. filed*, No. 95-1500; *Richardson v. Citibank (South Dakota), N.A.*, 908 P.2d 532, 533-34 (Colo. 1995) ("because Citibank is a national bank located in South Dakota, and South Dakota law permits the imposition of a late-payment fee, Citibank can charge Richardson a late payment fee despite the fact that a Colorado consumer protection law prohibited such fees"), *pet. for cert. filed*, No. 95-1493. *But see Sherman v. Citibank (South Dakota) N.A.*, 668 A.2d 1036 (N.J. 1995), *pet. for cert. filed*, 64 U.S.L.W. 3439 (Dec. 21, 1995) (No. 95-991); *Hunter v. Greenwood Trust Co.*, 668 A.2d 1067 (N.J. 1995), *pet. for cert. filed*, 64 U.S.L.W. 3439 (Dec. 18, 1995) (No. 95-963).

Bank Act (the "Act"). This 1864 Act established a banking system under direct federal-government control capable of distributing national currency and helping to finance the Union during the Civil War. *See generally* B. Hammond, *Sovereignty and an Empty Purse* 290 (1970). Section 85 of the Act regulates the interest that a national bank may charge on loans.

Section 85 authorizes a national bank, as a matter of federal right, to charge interest "on precisely the same footing [as state-regulated lenders] doing business in [its home] State by its laws." Cong. Globe, 38th Cong., 1st Sess. 2126 (1864) (remarks of Senator Sherman, the Act's principal drafter).[2] Specifically, section 85 of the Act provides that national banks may charge "interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85 (originally section 30, 13 Stat. 99, 108 (1864)). If a national bank exceeds that limit, section 86 provides the borrower's exclusive remedy: forfeiture of all interest due on the debt or, if the lender has already received the excessive interest, twice the amount of interest paid by the borrower. *See* 12 U.S.C. § 86. The Court has described sections 85 and 86 of the Act as "covering[] the entire subject" of national bank "interest" charges. *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 32 (1875).

The Court has construed the language of section 85 on four pertinent occasions; each decision was unanimous. In *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 409, 413 (1873), the Court ruled that section 85 empowers

[2] Section 85 originated in Section 30 of the 1864 Act. In 1873, the Act was amended and the portions of section 30 governing the interest allowed and the penalty for taking unlawful interest became sections 5197 and 5198, respectively, of the Revised Statutes. They were later codified as 12 U.S.C. §§ 85 and 86, respectively. The pertinent language has not changed since 1864. Language to which petitioner refers, authorizing the collection of interest measured by the discount rate at the district federal reserve bank, was added in 1933. *See* Banking Act of 1933, ch. 89, § 25, 48 Stat. 191.

a national bank to charge the same interest as the most favored state-regulated lender in its home state, even if that lender is not a bank. *See* 85 U.S. at 413. In *Daggs v. Phoenix National Bank*, 177 U.S. 549, 555 (1900), the Court held that if the national bank's home state sets no limit on interest charges, then the amount the national bank is "allowed" (and hence federally empowered) to charge is any interest agreed-to by the borrower. Four years later, in *Citizens National Bank v. Donnell*, 195 U.S. 369 (1904), the Court held that a monthly charge on overdrafts was "interest" within the meaning of section 85, rejecting as frivolous the claim that "this charge was [instead] a penalty because of a failure to pay a debt when due." *Id.* at 374. Finally, in *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 318 n.31 (1978), the Court held that a national bank may charge, on interstate credit card loans, interest at the rate allowed by the laws of its home state, even if the borrower's home state would prohibit the charge. According to the Court, under section 85 the borrower's state's law "must, of course, give way." 439 U.S. at 318 n.31.

B. Factual Background

More than 6,000 banks and other financial institutions in the United States provide credit card services to consumers. *See SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 960, 967 n.11 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 2600 (1995). There is "intense" competition on price, services, and other terms. *See The Profitability of Credit Card Operations of Depository Institutions*, Annual Report by the Board of Governors of the Federal Reserve System 6 (Sept. 1995) (hereinafter "FRB Report"). Credit card lending charges typically include a monthly "finance charge" on unpaid balances, as well as annual fees, late fees, and overlimit fees. All charges must be disclosed to consumers in the manner prescribed by the federal Truth-in-Lending Act. *See* Regulation Z, 12 C.F.R. §§ 226.5-226.9 (1993). As this Court has recognized, there is an interrelation between the components of a bank's "package" of charges: for

example, lower monthly finance charges may be offset by higher annual fees or late fees. *See Marquette*, 439 U.S. at 302-03. Banks formulate different packages of charges to appeal to different customers. *See* FRB Report at 8-9.

Citibank is located in Sioux Falls, South Dakota, and has no branches elsewhere. From that location, Citibank issues Visa, Mastercard, and other credit cards to customers nationwide. (P.A. 2). Citibank's credit card lending agreements generally provide for both percentage "finance charges" on cash advances and certain outstanding purchase balances and "late payment charges" if a cardholder does not make a required minimum payment by a specified date. (*Id.*) Late-payment charges may take the form of either a flat fee or a percentage of the borrower's account balance. (Joint Appendix ("J.A.") 56, 74; P.A. 40 n.17).

Petitioner entered into two standard credit card agreements with Citibank (J.A. 49-82; P.A. 6 n.2, 40 n.17). Each agreement allowed her to borrow on a revolving basis but required her to make a minimum payment each month. Each agreement imposed a monthly "finance charge" on certain outstanding balances, calculated as either a specified percentage of the average daily loan balance for the month, or a flat minimum charge of 50 cents, whichever was larger. Petitioner does not challenge the finance charge.

Each agreement also imposed a "late charge," assessed if petitioner did not make her minimum payment within a specified number of days after the payment due date. Specifically, petitioner's Classic Card Agreement provided that a late charge of $15 would be applied if petitioner's minimum payment was more than 25 days overdue. (J.A. 56). Petitioner's Preferred Card Agreement provided that a late charge of $6 would be applied if petitioner's minimum payment was more than 15 days overdue (J.A. 74); if petitioner were still delinquent at 30 days, she would be charged an additional late fee equalling the greater of $15 or 0.65% of the current

balance. This $15 or 0.65% fee would then be assessed for each succeeding month in which petitioner's minimum payment was more than 30 days overdue. (J.A. 74). These charges are allowed by South Dakota law.[3]

C. Proceedings in the California Courts

Petitioner, a California resident, brought this purported class action in Los Angeles Superior Court. She challenges Citibank's late-payment charges under California law, alleging that the late charges provided in her agreements with Citibank violated section 1671 of the California Civil Code. (P.A. 109-110, 114-18). That statute limits late charges to a "fair average compensation for a loss which would be sustained" on a borrower's default, as estimated in a study conducted by the lender. *See Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 511 P.2d 1197, 1202 (Cal. 1973). Petitioner seeks a trial to determine whether the charges were permissible under this California standard.[4] Petitioner does not dispute that Citibank is located only in South Dakota or that South Dakota's law allows the charges at issue without requiring the kind of study or judicial proceeding that petitioner seeks under California law.

Citibank moved for judgment on the pleadings dismissing the Complaint. Citibank argued that section 85 of the National Bank Act empowers Citibank to charge the "interest" allowed by its home state; that the term "interest" as used in section 85 includes late-payment charges; that Citibank's late-payment charges are permitted by Citibank's home state, South Dakota; and that under this Court's decision in *Marquette*, section 85 pre-empts any conflicting law of a borrower's state.

[3] S.D. Codified Laws Ann. §§ 54-3-1, 54-3-1.1 (1990) (Br. App. A, at 3a, 4a).

[4] California legislation that became effective on January 1, 1995, now permits banks located in California to assess specified late charges on credit card accounts. *See* Cal. Fin. Code §§ 4000-4001 (Deering Supp. 1995). Citibank's late fee charges are consistent with the charges authorized by the California Legislature.

The superior court denied Citibank's motion, and Citibank filed a petition for writ of mandate in the California Court of Appeal. The Court of Appeal ordered the superior court either to grant Citibank's motion or to show cause why its decision should not be reversed. The superior court's subsequent order granting Citibank's motion was affirmed by the Court of Appeal and the California Supreme Court.

Justice Mosk's opinion for the California Supreme Court noted that "[t]he issue is not the existence of preemption under section 85," because this Court's decision in *Marquette* establishes that a national bank may charge "interest" permitted by the law of its home state on interstate credit card loans and that any conflicting law of the borrower's state "must, of course, give way to the federal statute." 439 U.S. at 318 n.31. (P.A. 12-13).

The court then held that, as a matter of federal law, the term "interest" in section 85 "could include . . . a late payment fee, payable contingently in the event of default after maturity." (P.A. 19). It supported its decision by referring to the common legal usage of the term "interest" in 1864, the purpose of the Act (which it described as ensuring that a national bank stands in the shoes of the "most favored lender" within its home state), and the interpretation of the term "interest" in section 85 by the OCC, the federal agency charged with supervising the activities of national banks. (P.A. 18-25, 27-30). Accordingly, the court held that section 85 empowers a national bank to collect such charges as "interest" under federal law if other lenders located in the bank's home state are allowed to collect such charges, and that any contrary law of California is pre-empted. (P.A. 38-39). Two justices dissented, essentially on the ground that the "plain meaning" of "interest" encompasses only periodic percentage charges.

SUMMARY OF ARGUMENT

This case presents a single question of statutory construction: whether the word "interest" in 12 U.S.C. § 85 covers late-payment charges of the kind set forth in petitioner's credit card agreements with Citibank. This question is very important to national banks, their customers, and the nation's economy, but it does not implicate the broad issues of pre-emption theory or "federalism" to which petitioner devotes much of her brief.

An examination of the language, historical purpose, and consistent administrative construction of section 85 compels the conclusion that "interest" covers flat charges for the late payment of loans, such as those charged by Citibank in this case.

The Ordinary Legal Meaning. The ordinary legal meaning of "interest" in 1864 included all agreed charges for the use or detention of borrowed money. This Court contemporaneously described "interest" as the "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts,* 82 U.S. (15 Wall.) 177, 185 (1872). No narrower legal definition of "interest" was or is established as a matter of usage, and none would be workable in the context of state regulation of the price of credit.

Legislatures, courts, and dictionaries, in the nineteenth century as well as today, commonly applied the term "interest" to a wide range of charges for borrowed money. These included both charges assessed before maturity and new or increased charges triggered by the failure to pay a loan on time. They also included charges stated in flat-rate as well as percentage terms. For centuries, courts have held that a flat charge for the use or detention of money is "interest" and must be counted against a state ceiling on "interest," even if the ceiling itself is stated in percentage terms. Were it otherwise, state limitations on "interest" could be evaded with impunity.

Congress' use of the word "rate" in the phrase "interest at the rate allowed in the laws of the State" does not (as petitioner suggests) imply that Congress meant to limit the statute to percentage rates. First, in 1864, as now, the word "rate" referred to both flat amounts and percentages. Noah Webster, in 1828, defined "rate" as: "Price or amount stated or fixed on anything." Second, state courts routinely applied statutes governing the "rate" of interest to flat charges. There is no reason to believe that Congress used "rate" in a narrower sense than the dictionaries, legislatures, and courts of its time.

Petitioner argues that Citibank's late charges are too high, or, as she puts it, more than "compensatory," and that they are therefore not "interest" but "penalties." But petitioner's contention that in this context "interest" and "penalties" are distinct categories is simply wrong: this Court in *Donnell* rejected the argument that charges are not "interest" because they can be labeled "penalties." And while state courts have disagreed as to whether and in what circumstances late-payment charges should be disallowed as "penalties," the courts have agreed with *Donnell* that "penalty" charges are "interest."

The argument that only "compensatory" charges are "interest" in section 85 also ignores Congress' intent that the law of South Dakota, not that of California, determines whether Citibank's package of charges, or any of them individually, is an appropriate amount. In *Daggs, supra,* the Court held that a national bank, located in a state that allows state-regulated lenders to charge (with a borrower's agreement) *any* amount of interest, has a federal right to do the same. Petitioner's attempt to reverse section 85, by reading into the statute an *a priori* "compensatory" test, and declaring that a charge that fails her test can be regulated by California, fits neither the law nor the practicalities. National banks that make credit card loans have many different kinds of lending costs. A bank might seek to recover all its costs by charging a single percentage rate, but many lenders have

found that more complex packages fit the needs of their borrowers. For example, a borrower might choose to agree to a contingent late charge to obtain a lower monthly percentage charge. Credit card lenders develop these charge packages under conditions of intense competition, and their individual component charges are economically intertwined. There is no *a priori* litmus test, applicable in advance of the selection of the appropriate state law, for determining whether a particular charge is "compensatory."

Different states may regulate the packages of interest charges assessed by their lenders in different ways: some states may set elaborate legislated boundaries; other states might undertake to consider on a case-by-case basis whether a particular package, or a particular component of that package, is "compensatory"; and still other states, like South Dakota, may decide that competition is a sufficient regulator of the price of credit. But under section 85, the key point is that the question whether a particular charge for the use, detention, or forbearance of money should be disallowed as "non-compensatory" or for any other reason is to be answered by the law of the state in which the national bank is located.

Historical Purpose. Section 85 was passed in the midst of the Civil War and was designed to protect national banks against the "hazard" of "unfriendly state legislation," *Tiffany*, 85 U.S. at 412, by giving them the interest-charging rights of the "most favored lenders" in their home states. The history of intense state hostility to nationally chartered banks was well known to Congress. If section 85 is to achieve its purpose of securing the equal footing of national banks as against state-regulated lenders, "interest" must include all charges "for the use or forbearance of money, or as damages for its detention." *Hiatts*, 82 U.S. at 185, and not some narrower category of charges.

This is easy to illustrate, as various authorities have noted. If, for example, a home state imposed a low interest ceiling on all lenders, but permitted a few favored lenders (for example, credit unions) to collect late charges, and the term "interest" in section 85 was not interpreted to empower national banks to collect such late charges, national banks would be denied the "most favored lender" status that section 85 promised them.

The OCC's Interpretation. This Court has repeatedly said that when a term in a federal statute is ambiguous, and the agency responsible for overseeing the operation of the statute has defined the term in a reasonable manner, the agency's definition is entitled to controlling weight. The OCC is responsible for overseeing the banking activities of national banks, including their compliance with section 85, and this Court has repeatedly deferred to OCC interpretations of provisions of the National Bank Act.

In regulations published after notice and comment, the OCC has squarely answered the question presented in this case, stating that "interest" in section 85 includes all national bank charges for borrowed money, specifically including late-payment fees. These regulations are consistent with advice given (and relied on by national banks and state authorities) for several decades. If there is any doubt about the meaning of "interest" in the statute, the OCC's reasonable interpretation should be dispositive.

The Interstate Application of Section 85. If the Court agrees with Citibank that "interest" includes late-payment charges, this case is at an end. The term "interest" in section 85 must of course have the same meaning whether the bank's borrower resides within or outside the bank's home state. The only remaining question is whether section 85 displaces any contrary state law in states (outside South Dakota) where Citibank's borrowers reside, and the Court has already answered that question in *Marquette*, a case involving interstate credit-card lending. The Court held that section 85 empowers a national bank to charge the interest allowed by the law of its home state to a borrower who resides in another state and that

any contrary restriction in the law of the borrower's state "must, of course, give way to the federal statute." 439 U.S. at 318 n.31.

Petitioner argues that the presumption against preemption requires a "crystal-clear statement" that Congress intended the word "interest" to cover late charges, because there is an invasion of California's "historic police power." Her argument misstates both the law of preemption and the historic circumstances surrounding section 85, and it flies in the face of this Court's decisions construing federal banking laws: from *Marquette* to the very recent decision in *Barnett Bank v. Nelson*, No. 94-1837 (U.S. March 26, 1996).

The "ultimate touchstone" of pre-emption analysis is the intent of Congress, and the presumption is but one tool in discerning that intent. Here, there is more than ample evidence that Congress intended to empower national banks to collect any agreed charge for the use, forbearance, or detention of money allowed by their home states, and to pre-empt the law of any other state.

Moreover, no significant historic police power of California is at stake in this case. Before 1864, borrowers were traveling to borrow money from banks located in other states, on terms governed by the laws of those states. As the Court noted in *Marquette,* credit-card borrowing (which occurs at the bank's location) merely increases the ease and speed of such travel. At no time since 1864, when the national banks were created, has the borrower's state of residence had any role in regulating an interest charge by an out-of-state national bank.

Furthermore, the contention that Congress meant to consign different portions of the lending package to regulation by different states is implausible. Petitioner admits that any percentage charge, including any default charge stated as an increased percentage, is "interest" covered by section 85 and not subject to regulation by California. (Br. 30). She thus agrees that under South Dakota law Citibank may charge any percentage amount a borrower

agrees to, and therefore any total amount whatsoever, and California has no jurisdiction to complain. She also admits that California has no jurisdiction to regulate pre-default "up-front" flat-rate charges (Br. at 30), such as Citibank's flat 50-cent minimum finance charge. But she says, although California must stand aside for these charges, section 85 has reserved for California's jurisdiction a single strand of the lending fabric—a flat default charge, no matter how small the amount—so that California can judge whether that strand is fair and compensatory. She does not explain why California should assert jurisdiction over a single strand when the whole cloth is beyond its reach, or how her system would handle Citibank's Preferred Card late charge of 0.65% or $15, whichever is higher. Petitioner has offered no evidence that Congress intended section 85 to so fragment the regulation of a single lending package. In the absence of evidence that Congress intended such an illogical and inefficient result, section 85 should be construed, in accordance with its ordinary legal meaning, to include all charges for the use or detention of money, including the late fees at issue in this case.

ARGUMENT

I. THE TERM "INTEREST" AS USED IN 12 U.S.C. § 85 COVERS THE LATE-PAYMENT CHARGES AT ISSUE IN THIS CASE

Section 85 of the National Bank Act provides that national banks may charge "interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85. To determine the meaning of such a provision, the Court traditionally looks first to the language and purpose of the statute. If this analysis does not resolve the question presented, but there is a permissible construction of the statute by the responsible agency, this Court will defer to that construction. *See NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813-14 (1995); *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S.

837, 843 (1984). In this case, the language, purpose, and agency construction of section 85 of the National Bank Act all compel the conclusion, as a matter of federal law,[5] that the term "interest" includes fees imposed on credit cardholders for the detention of money past its due date.

A. The Ordinary Legal Meaning of "Interest" Includes Late-Payment Charges

Citibank's late fees are per-month charges imposed for keeping the bank's money past its due date. They are part of the package of fees charged by a lender—and agreed to by the borrower—as compensation for lending. Borrower delinquencies impose on lenders increased lending expenses, including higher loan-funding costs (the bank's cost of funds rises), higher and additional costs of administration and collection, and higher losses of principal (late payers are four to six times more likely than timely payers to default and become non-payers).[6] Late fees appropriately require delinquent borrowers to pay a

[5] Citibank agrees with petitioner that the meaning of "interest" under section 85 is a question of federal law. Citibank has never contended otherwise. Although the state in which a national bank is located determines the amount of interest that the bank is allowed to charge, a state can neither enlarge nor shrink the federal definition of "interest." The California Supreme Court agreed with this position and devoted the bulk of its opinion to analyzing the meaning of "interest" under the appropriate methods of statutory interpretation.

Accordingly, petitioner's first two Questions Presented are not actually at issue in this case. Specifically, (1) Citibank agrees with petitioner that Congress did not intend South Dakota law to define the federal term "interest"; the California Supreme Court also agreed, stating that "Congress has made no such delegation" (P.A. 30), and (2) the question whether Congress may constitutionally delegate to the states the task of defining the term "interest" is not presented because there has been no such delegation. The role of state law here in determining the amount of interest a national bank is federally empowered to charge is neither inappropriate nor unusual. *See United States v. Sharpnack*, 355 U.S. 286, 294 (1958).

[6] *See* Robert E. Litan, *The Economics of Credit Cards*, at 8 (Jan. 1993).

higher total compensation to the bank than those who are not delinquent.

Citibank's late fees fall comfortably within the ordinary legal meaning of the term "interest." At the time of the enactment of the National Bank Act, as well as today, "interest" was commonly understood to include all charges for borrowed money, regardless of whether the charges were imposed before or after default, stated in percentage or flat form, shown to recompense the lender for any particular lender cost, or deemed "more than compensatory" or "punitive" under the law of any particular jurisdiction.

1. *"Interest" Includes All Charges for the Borrower's Use and Detention of Money Due on a Loan*

Although the term "interest" has different meanings in different contexts,[7] when the issue is the permissibility of loan charges agreed to between lender and borrower, "interest" means all charges assessed for the use or detention of money whether before or after a borrower's default. This usage accords with common sense, as well as economic sense, because the charges all form part of the economic package of fees charged for the lending of money. It also accords with the long-prevailing interpretations of section 85 by the lower courts, which have applied the statute to loan charges of all kinds.[8]

[7] *See, e.g., Deputy v. Du Pont*, 308 U.S. 488, 498 n.11 (1940) (adopting narrow definition for purposes of tax deductibility and stating that there were "irrelevant other lines of authority . . . where 'interest' in a different context has been used to describe damages or compensation for the detention or use of money or of property"); *cf. NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 816 (1995) ("a characterization fitting in certain contexts may be unsuitable in others").

[8] *See Cades v. H&R Block, Inc.*, 43 F.3d 869, 873-74 (4th Cir. 1994) (flat service charges for tax refund anticipation loans), *cert. denied*, 115 S. Ct. 2247 (1995); *American Timber & Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982) (charges incurred by way of compensating balance requirements); *Fisher v.*

In defining the category of "interest" that, by statute, ceased to run during the Civil War, this Court stated: "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1872). *See also Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) ("Interest is given on money demands as damages for delay in payment, being just compensation to the plaintiff for a default on the part of his debtor"); *Shoemaker v. United States*, 147 U.S. 282, 321 (1893) ("Interest accrues . . . in the nature of damages, by reason of the failure of the debtor to pay the principal when due").[9] Contrary to

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First Nat'l Bank, 548 F.2d 255 (8th Cir. 1977) (credit card cash-advance fees); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 862 (6th Cir. 1972) (closing costs); *Panos v. Smith*, 116 F.2d 445, 446 (6th Cir. 1940) (mortgage taxes and recording fees); *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.) (bonuses or commissions), *cert. denied*, 290 U.S. 685 (1933); *Watson v. First Union Nat'l Bank*, 837 F. Supp. 146 (D.S.C. 1993) (credit card overlimit fees); *Attorney General v. Equitable Trust Co.*, 450 A.2d 1273, 1294 (Md. 1982) (returned check fees); *In re Gerber's Estate*, 9 A.2d 438, 443 (Pa. 1939) (brokerage charges); *Kenty v. Bank One, Columbus, N.A.*, No. C2-90-709, 1992 WL 170605, at 2-4 (S.D. Ohio Apr. 23, 1992) (charges for insurance on loan collateral); and, of course, the late charges at issue here (*see supra* n.1).

[9] Virtually every contemporaneous legal dictionary also included among the definitions of "interest" the payment of compensation for the use or detention of money, without any limitation as to either timing or form. For example, Timothy Cunningham stated that "[i]nterest is recovered by way of damages where damages are recovered *ratione detentionis debit*" (that is, "on account of (or by reason of) detention of a debt"). 2 Timothy Cunningham, *A New and Complete Law Dictionary* (Dublin 1764). John Bouvier defined "interest" as "[t]he compensation which is paid by the borrower of money to the lender for its use, and, generally, by a debtor to his creditor in recompense for his detention of the debt." 1 John Bouvier, *A Law Dictionary* 733 (Phila., J.B. Lippincott & Co., 14th rev. ed. 1877). *The American and English Encyclopedia of Law* noted that interest "is generally allowed by law on two grounds, namely, on contract, express or implied, or by way of damages, either for a default in the payment of a debt, or for

petitioner's lengthy argument, this Court did not adopt a narrower definition of "interest" in *United States v. Texas*, 507 U.S. 529 (1993): the Court there merely observed that the common law right of the United States to receive pre-judgment interest did not include the right to certain fees. The charges denoted by the word "interest" in a particular context obviously will not always include flat late charges.

At the time of adoption of the National Bank Act, the broad definition of "interest" reflected in *Hiatts*, *Redfield*, and *Shoemaker* was commonly understood to include not only charges for the use of money prior to default on a loan, but also new or increased charges triggered by the borrower's failure to pay on time. *See, e.g.*, *Hubbard v. Callahan*, 42 Conn. 524 (1875); *Wilkerson v. Daniels*, 1 Greene 180, 188 (Iowa 1848); cases cited at n.11, *infra*. Indeed, in 1864, the legislatures of many states and territories specifically defined "interest" to include post-default charges.[10] Courts in the same and other states

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a use or benefit derived from the money of another." 9 *The American and English Encyclopedia of Law* 380 (John Houston Merrill ed. 1890) (footnotes omitted). That source further noted that, "[w]here one has received the money of another and has not the right conscientiously to retain it, the law imposes interest as damages for the breach of an implied promise to pay it over." *Id.* at 397. And Alexander Burrill stated that "[i]nterest is an incident which the law gives the creditor, upon failure of the debtor to pay the principal." 2 Alexander M. Burrill, *A Law Dictionary and Glossary* 90 (N.Y., Baker, Voorhis & Co., Law Publishers 1870). *See also* 3 Giles Jacob, *The Law Dictionary Explaining the Rise, Progress, and Present State of the English Law* 505, 506 (T.E. Tomlins American ed. 1811) ("Interest is recovered by way of damages, where damages are recovered *ratione detentionis debiti*"); 2 Giles Jacob, *The Law Dictionary Explaining the Rise, Progress, and Present State of the English Law* (T.E. Tomlins London ed. 1809) (same).

[10] **Alabama:** prescribing interest rate to be applied "from the day such money . . . *should have been paid*," Ala. Code § 1520 (1852); **Arkansas:** allowing either agreed-upon or prescribed interest for "all moneys *after they become due*," Act of Mar. 20, 1939, ch. 92, § 1, 1858 Ark. Stat. Dig. 621; **California:** allowing either agreed-upon or prescribed interest for "all moneys *after they*

also routinely treated post-default charges as "interest." [11]

Accordingly, the historical evidence demonstrates that at the time of the enactment of the National Bank Act, "interest" was understood in the law to include additional or higher charges for the detention of money after its due date—charges that were triggered by (and thus contingent upon) the borrower's default. Many modern

become due," Act to Regulate the Interest of Money, ch. 31, § 1, 1850 Cal. Stat. 92 (1850); **Illinois:** rate of interest applied to money loaned "or *in any manner due and owing,*" Act to Legalize Ten Per Cent. Interest When It Is Agreed upon Between Parties, § 2, 1857 Ill. Laws 45, 46 (1857); **Iowa:** allowing either agreed-upon or prescribed interest for "all moneys *after the same becomes due,*" Act to Regulate the Interest on Money, ch. 72, § 1787, 1860 Iowa Rev. 316 (1853); **Louisiana:** providing that debts bear the prescribed interest rate "*from the time they become due,*" Act to Regulate the Rates of Interest, No. 291, § 1, 1855 La. Acts 352 (1855); **Minnesota:** providing that "all agreements and contracts shall bear the same rate of interest *after they become due* as before, if the same shall be clearly expressed therein," Act Fixing the Rate of Interest, ch. 56, § 1, 1860 Minn. Laws 226 (1860); **Mississippi:** providing that "it shall be lawful for parties to contract in writing for the payment of any rate of interest not exceeding ten per cent per annum upon any debt *after the maturity thereof,*" Act to Authorize Parties to Contract in Writing for the Rate of Interest, ch. 29, § 1, 1856 Miss. Laws 92 (1856); and **Ohio:** providing that "all creditors shall be entitled to receive interest on money, *after the same shall become due,*" Act Fixing the Rate of Interest, § 1, 1824 Ohio Laws 108 (1824). The territories included **Missouri:** allowing prescribed rate of interest for "all moneys *after they become due*" and agreed-upon rate of interest on "*money due* or to become due" Act of Mar. 24, 1845, ch. 88, §§ 1, 2, 1845 Mo. Rev. Stat. 614; and **New Mexico:** allowing agreed-upon or prescribed rate of "interest" for "*money due,*" Act Relating to Money and Interest, §§ 3, 4, 1851 N.M. Laws 254 (1852). *See also* **Idaho:** allowing prescribed rate of interest for "all moneys *after they become due*" and agreed-upon rate of interest on "money due or to become due," Act in Relation to Money of Account and Interest, §§ 4, 5, 1879 Idaho Sess. Laws 7, 7-8 (1879). (All emphasis added.)

[11] *See, e.g., Miller v. Kempner*, 32 Ark. 573, 574 (1877) (parties permitted to contract for post-maturity interest under constitutional provision providing that "parties were at liberty to contract for any rate of interest they might agree upon"); *Portis v. Merrill*, 33 Ark. 416, 418 (1878) (same); *McKay's Estate v. Belknap Sav. Bank*, 59 P. 745, 747 (Colo. 1899) (post-default interest permissible under statute providing that parties "may stipulate . . . for the payment of a greater or higher rate of interest than eight per cent per annum, and any such stipulation may be enforced in any court . . . ."); *Capen v. Crowell*, 66 Me. 282, 283 (1877) (interest recoverable under note stipulating higher rate of interest after maturity, under statute providing that "in the absence of any agreement in writing, the legal rate of interest shall be six per cent per year"); *Brannon v. Hursell*, 112 Mass. 63, 71 (1873) (plaintiff entitled to recover post-default interest at rate specified in contract, under statute making it lawful to contract in writing for "any amount" of interest); *Linton v. National Life Ins. Co.*, 104 F. 584, 593 (8th Cir. 1900) (provision in promissory note for increase in rate of interest after maturity was valid and enforceable under Nebraska statute permitting parties to agree to amount of interest); *Hopkins v. Crittenden*, 10 Tex. 189, 189-90 (1853) (post-maturity charges were interest); *Cecil v. Hicks*, 70 Va. (29 Gratt.) 1 (1877) (post-default charges were interest).

statutes and courts have applied a similar definition.[12] Indeed, petitioner appears to accept this meaning of the

[12] *Statutes:* Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. App. § 526 ("'interest' includes service charges, renewal charges, fees, or any other charges"); **Del.** Code Ann. tit. 5, § 950 ("[A] bank may impose, as interest, a late or delinquency charge . . . ."); **S.D.** Codified Laws Ann. § 51-A-12-13 (defining all authorized fees, including late fees, to be "deemed interest"); **Ga.** Code Ann. § 7-4-2(a)(3) (Michie) ("[T]he term 'interest' means a charge for the use of money . . . over the term of the contract at the rate stated in the contract or computed in any other way or any other form."); **Ill.** Ann. Stat. ch. 205, sec. 675/6 (Smith-Hurd) ("[A] financial institution may, if the agreement governing the revolving credit plan so provides, charge and collect as interest, in such manner or form as the plan may provide, an annual or other periodic fee for the privileges made available to the borrower under the plan, a transaction charge or charges, late fees or delinquency charges, returned payment charges, over limit charges and fees for services rendered."); **Ohio** Rev. Code Ann. § 1107.262(A) (Baldwin) ("[A] bank may charge, collect, and receive, as interest, other fees and charges that are agreed upon by the bank and the borrower, including, but not limited to, periodic membership fees, cash advance fees, charges for exceeding a designated credit limit, charges for late payments, and charges for the return of a dishonored check."). *Courts: Gordon Fin. Co. v. Chambliss*, 236 So. 2d 533, 535 (La. Ct. App. 1970) (holding that

term, conceding, for example, that higher periodic percentage-based charges following default for the delay in repayment would properly be considered "interest" even under her theory. (Br. 30).

2. *"Interest" Includes Flat as Well as Percentage Charges*

The authorities also make clear that "interest" has always included charges for borrowed money—whether prematurity or post-maturity—that are stated in flat rather than percentage terms. *See, e.g., Wernwag v. Mothershead*, 3 Blackf. 401, 402 (Ind. 1834) (five dollar per week late-payment charge was permissible "*interest at the rate* specified in the note from the time it became due") (emphasis added); *Fry v. Coleman*, 1 Pa. 445, 447 (1857) (agreement to pay $100 if loan not paid within ten days after maturity was forbidden by usury law); *Craig v. Pleiss*, 26 Pa. 271, 273, 274 (1856) (flat charge of $25 was a "*rate of compensation*" within usury statute) (emphasis added); *Ferrier v. Scott's Adm'rs & Heirs*, 17 Iowa 578 (1864) (flat charge to extend a note beyond its original term); *Melville v. American Benefits Bldg. Ass'n*, 33 Barb. 103, 114 (N.Y. 1860) (aggregated total of amounts labeled monthly fees, dues, and penalties was excessive interest under usury law); *Swartwout* v. *Payne*,

$5 delinquent charge on installment note was "interest" under state usury statute); *Swindell v. Federal Nat'l Mortgage Ass'n*, 409 S.E.2d 892, 895 (N.C. 1991) (state usury statute applies to late payment charge of five percent on overdue mortgage payments); *Douglas Elecs., Inc. v. Pinnacle Sys., Inc.*, 805 S.W.2d 852, 857 (Tex. Ct. App. 1991) (late fee of 1.5% per month on outstanding account balance was subject to usury statute); *Veytia v. Seiter*, 740 S.W.2d 64, 65 (Tex. Ct. App. 1987) ("Absent statutory language to the contrary, late charges are interest within the meaning of the usury statutes"; usury statute applies to late charges of $20 per day on mortgage payments, *aff'd*, 756 S.W.2d 903 (Tex. 1988); *see also Scarr v. Boyer*, 818 P.2d 381, 383 (Mont. 1991) increase in interest rate after default on not is subject to state usury statute).

19 Johns. 249 (N.Y. Sup. Ct. 1822) ($15 "premium" to refinance matured note was usurious).[13]

There is no principled reason why the word "interest" would exclude flat charges that are paid for the use or detention of money, and, except for contending that all flat late charges are supracompensatory "penalties" (*see* Part A.3., *infra*), petitioner does not attempt to advance one. In determining whether loan charges exceeded statutory ceilings on "interest," courts have commonly included in their calculations not only flat charges, but even charges paid in goods rather than money.[14] If such charges were not included, the legal limits on interest could be easily circumvented. Indeed, consumer credit statutes often express limits on monthly finance charges, and late charges, in both percentage terms and flat terms.[15]

[13] *See also Scofield v. McNaught*, 52 Ga. 69, 71 (1874) (seller of house violated ten percent usury ceiling by requiring purchaser to pay $700 per year flat rental charge, court noting that "calling it rent need not alter the legal effect of the transaction so far as the question of usury is concerned"); *Mills v. Salisbury Bldg. & Loan Ass'n*, 75 N.C. 292, 299 (1876) (total amount of interest, dues, and fines levied for failing to pay timely the various monthly payments exceeded usury ceiling); *Hollowell v. Southern Bldg. & Loan Ass'n*, 26 S.E. 781 (N.C. 1887) (charge of $5 as "interest" and $12 as "dues" amounted to more than the legal interest rate); *Meroney v. Atlanta Nat'l Bldg. & Loan Ass'n*, 21 S.E. 924 (N.C. 1895) (holding that association charges, including a "sum of $3 per month as interest and premium on said advance," were usurious).

[14] *See, e.g., Smith v. Smith*, 45 Pa. Super. 353, 356-57 (1911) (holding that it was "immaterial in what form or pretense" the interest was charged and that four atlases given as bonus for a loan were within usury statute); *Eason v. Saulsbury, Respess & Co.*, 51 Ga. 507 (1874) (charge paid in cotton); *Heytle v. Logan*, 1 A.K. Marsh. 529 (Ky. 1819) (charge paid in real estate).

[15] *See, e.g.*, Uniform Consumer Credit Code ("UCCC") § 3.201 (1968 Act) (maximum credit service charge on revolving loans of X% annually or 50 cents per month, whichever is larger); UCCC

In response, petitioner argues that "interest" as used in section 85 must be limited to percentage charges because section 85 refers to "interest at the rate allowed" and only a percentage charge can be a "rate." This argument fails for two reasons.

First, section 85 provides that "the laws of the State, Territory, or District" shall determine the "rate allowed," and the statute does not limit such laws to those specifying percentages. As a matter of ordinary English usage, in the nineteenth century and now, a "rate" need not be a "percentage rate."

The leading nineteenth-century American dictionary defined "rate" as: "[p]rice or amount stated or fixed on anything," and then gave the following examples of this particular usage: "A king may purchase territory at too dear a *rate*. The *rate* of interest is prescribed by law." 2 Noah Webster, *American Dictionary of the English Language* (N.Y., S. Converse ed., 1828) (emphasis in original). There can be no doubt that this definition encompassed flat charges.

Modern definitions of "rate" are equally broad. *See* 13 *Oxford English Dictionary* 208 (1989) ("a fixed charge applicable to each individual case or instance"); *see also Webster's Third New International Dictionary* (Unabridged) 1884 (2d ed. 1971) ("a fixed or established portion or measure").[16] In modern usage, the word "rate"

§ 2.202 (1974 Act) (same); UCCC § 3.203 (1968 Act) (late charge on precomputed loan of $5 or 5% of the unpaid installment, whichever is larger, "however long it remains in default"); UCCC § 2.502 (1974 Act) (same). Many states have adopted these UCCC model provisions or similar standards. *See U.L.A. Directory of Uniform Acts & Code* (1995 Pamphlet).

[16] *See also Random House Dictionary of the English Language* 1602 (2d ed. 1987) (definitions include "'price' or 'cost'" and the example given is "to cut rates on all home furnishings"); *Webster's Ninth New Collegiate Dictionary* 976 (1991) (first definition is "as reckoned value); *see also Black's Law Dictionary* 639 (6th ed. 1990) ("Flat Rate: Fixed amount paid each period without regard to actual amount of electricity, gas, etc. used in that particular period").

includes, for example, the flat per-night cost of a hotel room ("hotel rates"), flat "telephone rates" for installing a line, and flat fares for transportation of goods or persons, which are regulated as "rates." [17]

Second, state usury statutes that use the word "rate" in a phrase like "interest at the rate" have, for centuries, been routinely applied to flat charges. *See supra* pp. 20-21. It is just a matter of arithmetic to determine whether a fixed charge, alone or together with other charges, exceeds a state ceiling expressed as a percentage. Thus, the issue has never been whether the particular state's ceiling on interest, if there is one, is stated in terms of a "rate." The issue, instead, is whether flat charges for borrowed money are "interest," such that they count against that "rate" ceiling; if not, the state's ceiling could be evaded with impunity.

If flat charges are "interest" for purposes of determining whether the lender's charges exceed a state-specified ceiling, they are equally "interest" in a state like South Dakota that sets no ceiling and allows whatever charges are agreed between lender and borrower. The point is illustrated by *Daggs v. Phoenix National Bank*, 177 U.S. 549 (1900). That case involved a national bank located in Arizona. Arizona's usury statute specified a percentage-rate ceiling on "interest" in the absence of a contract, but permitted parties to agree by contract to any "rate of interest." *See id.* at 554. The issue under section 85 was whether "the rate allowed" in Arizona encompassed any amount of interest agreed between the national bank and a borrower, even though Arizona had specified no "rate of interest" whatsoever for contracting parties. The Court's answer was yes: "[t]he intention of the national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks

[17] *See, e.g., Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 388 (1992) (holding that National Association of Attorneys General guidelines that referred to "air fares" related to "airline rates" for purpose of the Airline Deregulation Act of 1978).

organized by it." *Id.* at 555.[18] The principle recognized in *Daggs* was that a state can remove all restrictions on the "rate of interest" to which parties can agree; and if a state, following the example of Arizona, permits lenders and borrowers to agree upon unlimited amounts of interest at unrestricted rates, national banks and their borrowers have the same right.[19]

Petitioner concedes that flat charges (such as Citibank's 50-cent minimum finance charge) may be "interest" (Br. 30), but appears to limit that concession to flat amounts charged prior to the default on a loan. But there is no logical or economic reason to distinguish between flat amounts charged before maturity for the use of money and flat amounts charged after default for the money's use and detention. In either case, borrowers, lenders, and courts can and do calculate whether flat loan charges, when added to any other charges, have exceeded that ceiling. While it may not be possible to determine whether a certain late charge exceeds a given percentage ceiling until after the charge is actually incurred (because the account is a revolving one), that has no bearing on whether such a ceiling can in fact be applied. *See Paulat v. Pirello*, 353 So. 2d 1307, 1310 (La. 1977) (even if a note is not usurious on its face, payments made following maturity of the note that in fact exceed the usury rate constitute usurious interest); *Dixon v. Brooks*, 604

[18] Petitioner cites *National Bank v. Johnson*, 104 U.S. 271 (1881), for the contrary proposition; that is, that Congress intended only to adopt the states' numerical percentage limits (Br. 4, 19, 23, 24). The Court in *Daggs* specifically rejected the interpretation of *Johnson* that petitioner advances, noting that any remarks in *Johnson* "which seemed to imply that a rate allowed by a state law" was limited to a "fixed" numerical percentage "were not necessary to the decision, and cannot be considered as expressing the judgment of the court." *Daggs*, 177 U.S. at 556.

[19] *Cf. Citizens Nat'l Bank v. Donnell*, 195 U.S. 369, 373 (1904) (section 85 adopts national bank's home state's law concerning permissible means of calculating the "rate" of interest).

S.W.2d 330, 333-34 (Tex. Civ. App. 1980) (under Texas law, "[t]o be liable for usury penalties, one must contract for, charge or receive interest which is greater than the amount authorized by law") (emphasis added); *A.Y. McDonald Mfg. Co. v. Shackelford*, 652 S.W.2d 8, 9 (Ark. 1983) ("the debtor need not agree to a usurious rate of interest in order for the charge to be void; it is enough that the rate is charged") (citation omitted).

Finally, petitioner is also wrong in asserting that the clause in section 85 that gives national banks the alternative of charging interest "at a rate of 1 per centum per annum in excess of the [Federal Reserve] discount rate" means that the bank's charges must be stated as percentages. In the first place, this provision, which was added to the statute in 1933, simply provides an alternative to the "state rate" and there is no evidence that it was intended to alter the meaning of the language at issue in this case.[20] More fundamentally, it is clear for the reasons already discussed that even if the Federal Reserve rate were always expressed in percentage terms, there is no reason why a flat charge would not count in determining whether that ceiling was exceeded.

3. *Charges for the Detention of Money Are "Interest" Even if the Charges Are Not Shown To Be Compensatory or Are Labeled "Penalties"*

Petitioner asserts that Citibank's charges are not "interest" but "penalties." The distinction, however, relates only to the enforceability of interest and not to its definition or scope. A charge for the detention of money past its due date is "interest" even if, under applicable law,

[20] The legislative history of the 1933 Act provides little insight into congressional intent regarding this addition, although Representative Luce characterized the discount rate clause as a "minor provision." *See* 77 Cong. Rec. 3916 (1933).

it is deemed to be "punitive" and (perhaps) therefore not enforceable.[21]

This Court has already held that an amount that a national bank actually charges (and a borrower agrees to pay) for borrowed money is "interest," even if it might be labeled a "penalty." In *Citizens' National Bank v. Donnell*, 195 U.S. 369 (1904), a national bank had assessed an overdraft charge of 12 percent, which exceeded the amount allowed by its home state. The lender sought to avoid what is now section 85 by arguing that "this charge was a penalty because of a failure to pay a debt when due, and therefore not usurious." *Id.* at 373-74. The Court swiftly dismissed this argument, holding that the charge was covered by (and violated) section 85.

The Court's holding in *Donnell* is only one of a long line of cases recognizing that contracted-for post-default charges are "interest" regardless of whether they can *also* be characterized as "penalty" charges.[22] For example, in *Hubbard v. Callahan*, 42 Conn. 524 (1875), the defendant borrower argued that an agreed-to post-default rate

[21] As one annotator summarized the judicial decisions addressing late-payment charges: "[w]hile a number of cases have treated such stipulations as 'penalties,' the term 'penalty' has been used in different senses, and thus the 'penalty' characterization does not provide a useful, independent basis for categorization." Gary D. Spivey, Annotation, *Validity and Construction of Provision Imposing "Late Charge" or Similar Exaction for Delay in Making Periodic Payments on Note, Mortgage or Instalment Sale Contract*, 63 A.L.R. 3d 50, 58-59 (1975).

[22] *See, e.g.*, *Union Estates Co. v. Adlon Const. Co.*, 116 N.E. 984, 985 (N.Y. 1917); *National Life Ins. Co. v. Hale*, 154 P. 536, 537 (Okla. 1916) (citing additional authority); *Havemeyer v. Paul*, 63 N.W. 932, 937 (Neb. 1895); *Reeves v. Stipp*, 91 Ill. 609, 611 (1879); *Dorris v. Merrill*, 33 Ark. 416 (1878); *Capen v. Crowell*, 66 Me. 282 (1877); *Downey v. Beach*, 78 Ill. 53, 54 (1875); *Davis v. Hendrie*, 1 Mont. 499, 505 (1872); *Wilson v. Dean*, 10 Iowa 432, 433 (1860); *Horner v. Hunt*, 1 Blackf. 213, 214 (Ind. 1822); *Waller v. Long*, 20 Va. (6 Munf.) 71, 78 (1818); *see also* cases cited in 12 A.L.R. 363, 363-64 (1921).

of 15% was not "interest," under a statute providing that "it shall be lawful to contract for the payment and receipt of any rate of interest," because the amount exceeded what was needed to compensate the lender and therefore constituted a "penalty." *Id.* at 526-27. The court flatly rejected that argument with the following reasoning:

> It would strike most commercial and business men with surprise, if they were told that *all that is received or paid for the use of the money* so loaned was not interest, but mere damages for the breach of contract, and that the parties could not, if they would, make it interest, even by an express agreement to that effect.
>
> If then there is any limitation of the power of parties to contract in this regard, it must be found in some extremely technical definition of the word "interest" as used in the statute. *And the defendant's claim is that the word "interest" in law necessarily imports a compensation for the use of money until the principal is due. This claim however is not well sustained by authorities.*

Id. at 528 (emphasis added). *See also id* at 528-35 (citing extensive precedent).[23]

While petitioner asserts a rigid distinction between "interest" and "penalties," her cases show no such thing. They show only that there were exceptions to the law of usury, so that an amount that was regarded as "interest" might or might not be "usurious."[24] In *Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 226 (1830) (cited Br. 33), the Court held that plaintiff borrower should be permitted to

[23] *See also Library of Congress v. Shaw*, 478 U.S. 310, 314 n.2 (1986) (the institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan).

[24] For a further explanation of the distinction between "usury" and "interest," see J. Kelly, *A Summary of the History and Law of Usury in England* *60 (1852), *reprinted in The Law Library* (Phila., T. & J.W. Johnson, Law Booksellers 1852).

show that an "annuity," which would have been outside the usury laws, was an artifice to evade those laws; the case had nothing to do with the definition of "interest." In *Spain v. Hamilton's Adm'r*, 68 U.S. (1 Wall.) 604 (1863) (cited Br. 33), the Court said, conversely, that the borrower's agreement to forfeit certain funds did not render a loan usurious, because there was no evidence that the forfeiture was an artifice to evade the usury laws; again, the case had nothing to do with the definition of "interest." Finally, the court in *Merchants' Nat'l Bank v. Sevier*, 14 F. 662 (C.C.D. Ark. 1882) (cited Br. 36-37), noted that states were divided on the enforceability of contract clauses requiring a defaulting borrower to pay an attorney's fee, *id.* at 662-63, but held that such a clause was a cover for usury and unenforceable in Arkansas, *id.* at 665. As in *Lloyd* and *Spain*, the court did not discuss the meaning of the term "interest."

Petitioner alleges that although she agreed to Citibank's charges, they are more than is necessary to compensate Citibank for the costs of her default. (Br. 38-39). But this is just an argument that Citibank's charges are in her view too high and unfair given the circumstances of the loan. Section 85 commits that question to the laws of Souht Dakota: Petitioner is not entitled to a determination under California law of whether the charges are excessive because they are allegedly "supracompensatory" or for any other reason.

To be sure, in the nineteenth century, different states had, as they do today, different policies governing when interest charges become "unfair," "non-compensatory," or "punitive," and therefore unenforceable. In many cases, ordinary percentage charges, which petitioner concedes are "interest," were labeled "punitive" and not enforceable.[25] Other courts, in other states, found very similar

[25] *See, e.g.*, *Scottish-American Mortgage Co. v. Wilson*, 24 F. 310, 312 (C.C.D. Kan. 1885) (provision that upon default, interest on principal sum would increase from 7% to 12% retroactive to making of note was unenforceable penalty); *Connecticut Mut. Life*

interest charges enforceable because the parties had agreed to them.[26] *See New Orleans v. Warner*, 175 U.S. 120, 147 (1899) ("where there is a promise to pay upon a certain day with interest at an exorbitant rate, the creditor is only entitled to interest after that time by operation of law and not by contract; although if the local law be different this Court will follow it."). The crucial point, however, is that courts on both sides of the divide referred to such charges as "interest." [27]

Ins. Co. v. Westerhoff, 78 N.W. 724, 725 (Neb. 1899) (provision that upon default in an installment payment the entire principal would bear interest at higher rate was unenforceable penalty); *Krutz v. Robbins*, 40 P. 415, 416 (Wash. 1896) (same); *Conrad v. Gibbon*, 29 Iowa 120, 121 (1870) (similar to *Scottish American*); *Mosby v. Taylor*, 21 Va. (Gilmer) 172, 173 (1821) (same); *Smithers v. Gough*, 2 Ky. (Sneed) 346 (1805) (same).

[26] *See, e.g., Fisher v. Anderson & Froth*, 25 Iowa 28, 30 (1868) (holding that increased interest from the time of the making of the note could be recovered); *Rogers v. Sample*, 33 Miss. 310, 312 (1857) (same, and recognizing conflict); *C.B. Bowler & Co. v. Houston*, 1 Ohio Dec. 560, 507 (Ohio C.P. 1851); *Gully v. Remy*, 1 *Blackf.* 68, 70 (Ind. 1820) (same); *Ramsey v. Matthews*, 4 Ky. (1 Bibb) 242, 243 (1808) (same, and recognizing conflict).

[27] *Compare Nicholls v. Maynard*, 3 Atk. 519, 520 (Eng. Ch. 1747) ("Where the *interest* is to be increased, if not paid at the day, that is but as a *nomine poenae*, and relievable in equity"); *Strode v. Parker*, 2 Vern. 316, 317, 23 Eng. Rep. 804, 805 (Ch. 1694) ("where the interest is to be increaser, if not paid at the day, *that* is but in the nature of a penalty and relievable in equity"); *with Fisher v. Anderson & Froth*, 25 Iowa 28, 30 (1868) (holding that increased *interest* from the time of the making of the note could be recovered); *Rogers v. Sample*, 33 Miss. 310, 312 (1857) (same, and recognizing conflict); *C.B. Bowler & Co. v. Houston*, 1 Ohio Dec. 506, 507 (Ohio Ct. Common Pleas 1851) ("the note in controversy was a good contract, and the *interest* from date could be collected"); *Gully v. Remy*, 1 Blackf. 69, 70 (Ind. 1820) ("The *interest* it is contended, is nothing more than a penalty"; but lower court "acted rightly in allowing interest on the obligation from its date"); *Rumsey v. Matthews*, 4 Ky. (1 Bibb) 242, 243 (1808) (rejecting argument that "*interest* from the date provided the principal is not paid by a particular day, can only be considered as a *nomine peonae*"). (All emphasis added). As one commentator observed, the cases "held or recognized that it was not usurious to provide in a promissory note or other contract for the payment of

Petitioner's contention that it is possible to determine *a priori*, based on the form of a charge, whether it is "compensatory" and then to use this determination to decide which state(s) have regulatory jurisdiction over a particular charge, is wrong on two counts. First, petitioner's claim (Br. 30-31, 31 n.14, 32-33) that a charge is inherently not compensatory if it is not expressed as a percentage of the loan and measured by time[27] has no merit. Lenders' costs include not only the time value of the money lent but other costs that may not be proportional to either the balance or the time, including the costs of setting up and administering individual accounts; tracking defaults and adjusting the rights of defaulting borrowers; collecting amounts in default; and losing part or all of the principal when a late payer later becomes a nonpayer.[29] A lender might attempt to

money, for *interest* after maturity at a rate in excess of the lawful rate . . . (because) such a provision is in the nature of a penalty which has as its purpose the iducement of prompt payment of money owed when due." J.D. Perovich, Annotation, *Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious or Otherwise Illegal*, 28 A.L.R. 3d 449, 454 (1969). (Emphasis added).

[28] Citibank's late charges do, of course, accrue "over time." They are charged on a per-month basis for each monthly period in which a borrower delays repayment for more than 25 days after the due date (or, in the case of the Preferred Card, for more than 15 days in the first month and 30 days in succeeding months). *See* pp. 5-6, *supra*.

[29] *See Meilink v. Unemployment Reserves Comm'n (In re United Lamp & Shade Corp.)*, 314 U.S. 564, 567 (1942). Petitioner argues that the court in *Meilink* recognized a distinction between penalties and "interest." That case does not recognize petitioner's distinction and, in fact, controverts her argument that "interest" charges must be compensatory. In *Meilink*, the court considered whether a "twelve percent per annum" interest charge was dischargeable as a "penalty or forfeiture" under the Bankruptcy Act, where the relevant state law provided a seven percent usury ceiling. *Meilink*, 314 U.S. at 566. The Court held that the charge was not a penalty, even though it was above the legal rate, and went on to note that "[w]e cannot be so confident here that . . . an exaction in excess of such value [for the use of money] cannot be merely an interest charge." *Id.* at 569.

recover all of these costs through a sufficiently high percentage rate on all outstanding balances, but it may also, as Citibank and other lenders have done, offer more tailored packages of charges that are expected to recover their costs[30] and be more attractive to most customers. Packages that include late fees are economically rational because they enable the lender to collect from defaulting borrowers a portion of the extra costs they impose. This allows the lender to reduce the percentage finance charge to borrowers who pay on time. Given the myriad of economic factors and borrower preferences bearing on the pricing of credit, there can be no universal test for determining whether the chosen fabric of lending charges —let alone a single strand of the weave—is "compensatory."

Second, the fundamental point of section 85 is that the question whether all or some of a lender's package of charges should be disallowed—because the charges exceed some determination of what is needed to compensate the lender, or exceed a specified ceiling, or exceed some other measure of appropriate amount—is to be determined under the law of the national bank's home state. States may choose to regulate such charges in any of a variety of ways. State *A's* legislature, for example, might hold hearings and determine that a specified flat fee or percentage-rate charge is sufficient and impose that as a ceiling. State *B's* courts might (notwithstanding the practical difficulties) require the lender to prove its actual costs incurred on a particular credit card loan or on average. State *C* might decide that with many lenders competing intensely in a nationwide credit card lending market *no* regulation of interest charges is warranted. But whatever the method chosen by a particular state to regulate the rate of interest, section 85 makes clear that national banks located within that state will be allowed to

[30] *See, e.g., Marquette*, 439 U.S. at 302-03 (flat annual fees can compensate credit card lender who offers lower annual percentage rate for finance charges).

charge that rate, and it denies any other state the right to impose its own views of what charge is appropriate. Petitioner is simply trying to apply California law to a legal issue that section 85 assigns to the law of South Dakota.

B. The Purpose of Section 85 Requires That "Interest" Include All Charges for the Use or Detention of Money, Including Flat Late-Payment Charges

As petitioner admits (Br. 3-5), Congress enacted section 85 of the National Bank Act in 1864 to protect national banks against the "hazard" of "unfriendly state legislation." *Tiffany*, 85 U.S. (18 Wall.) at 412. Congress was concerned that state governments might attempt to restrict the lending power of the newly chartered national banks that were being created to help finance the Civil War and stabilize the Union's economy. Bray Hammond, *Sovereignty and an Empty Purse* 290 (1970).[31] Thus, Congress intended to protect national banks by ensuring that they would be able to charge interest "on precisely the same footing [as state-regulated lenders] doing business in [their home] State by its laws." Cong. Globe, 38th Cong., 1st Sess. 2126 (1864) (remarks of Senator Sherman).

If section 85 is to achieve its "most favored lender" purpose, "interest" must be understood, in accordance with its ordinary meaning in similar contexts, to cover all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Hiatts*, 82 U.S. at 185. As several courts have pointed out, if "interest" were not interpreted to cover charges for borrowed money other than percentage finance charges, national banks could be at a disadvantage compared with rival state-regulated lenders. *See Greenwood Trust*, 971 F.2d at 827 & n.8; *Fisher v. First Nat'l*

[31] In fact, the National Bank Act became politically feasible only because of the secession of the states that had led the attacks on the First and Second Banks of the United States. 1 *A History of Banking in All the Leading Nations* 464 (William G. Sumner ed.) (1896).

Bank, 548 F.2d 255, 259-60 (8th Cir. 1977); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 862 (6th Cir. 1972). Similarly, the OCC has explained that "Congress intended the term 'interest' in section 85 to include any kind of lending charge allowed to state lenders in order to achieve Congress' goal of putting national banks on at least as strong a footing as the most favored lender subject to state control." Julie L. Williams, OCC Chief Counsel, Interpretive Letter No. 670, [1944-1995 Transfer Binder] Fed. Banking L. Rep. ¶ 83,618, at 71,834 (Feb. 17, 1995).

For example, under the construction of section 85 proffered by petitioner, a state could permit a favored class of lenders (perhaps credit unions or finance companies or individuals) to assess late charges without extending the same right to banks. If section 85 did not apply to such charges, banks, including national banks, would be at a disadvantage and would be forced to increase other charges to compensate for the revenue they could not obtain from late charges. As a result, national banks could not compete on a level playing field with the favored lenders. That result would not necessarily be unconstitutional (if the distinction between different kinds of lenders were rational and the line were not drawn between in-state and out-of-state lenders), but it would deprive national banks of their statutory most-favored-lender position.

The example is true to life. Until recently, California law allowed California-chartered credit unions to charge late fees at a flat rate of $5,[32] but subjected banks to standards that might impose lower limits.[33] In order to place national banks on the same footing as the "favored" credit unions in California, section 85 must apply to flat late charges.

[32] *See* Cal. Fin. Code Ann. § 15001 (West 1989).

[33] *E.g.*, *Beasley v. Wells Fargo Bank, N.A.*, 1 Cal. Rptr. 2d 446 (Cal. App. 1991).

The legislative history of section 85 further supports the conclusion that Congress intended an inclusive reading of "interest." The debates reveal that Congress decided to empower national banks to collect interest at the rate "allowed" rather than "established" by their home states in order to ensure that national banks would have the benefits of state laws allowing lenders and borrowers to contract for *any* rate of interest.[34] In *Daggs, supra,* 177 U.S. at 555, this Court confirmed that Congress chose the term "allowed" in order to give national banks the right to assess any agreed-upon rate of interest in those states[35] in which such agreements were enforceable, even

[34] The version of section 30 of the National Bank Act reported to Congress by the Senate Finance Committee used the phrase "[t]he rate *allowed* by the laws of the State or Territory where the bank is located, and no more." *See* Cong. Globe, 38th Cong., 1st Sess. 1871 (1864) (emphasis added). Senator Grimes of Iowa proposed amending the bill to replace the word "allowed" with "established." *See* Cong. Globe, 38th Cong., 1st Sess. 2124. Senator Grimes sought to limit national banks to the legal rate of interest affirmatively authorized by the state and to prohibit national banks from agreeing to a higher rate in the contract (as thirteen state and territorial usury statutes parmitted local lenders to do). *See id.* at 2125 (remarks of Sen. Grimes). Senators from states whose statutes permitted parties to agree to any interest set forth in the contract emphasized, however, that their home states' banks would not take federal charters unless the language was broadened to permit a national bank to charge any interest "allowed" by the laws of the bank's home state, thus ensuring that the national banks could charge whatever interest was available to private parties by contract. *See, e.g.,* Cong. Globe, 38th Cong., 1st Sess. 2126 (remarks of Sen. Trumbull); *id.* at 2127 (remarks of Sen. Fessenden). The members advocating broader lending powers for national banks won the debate.

[35] *E.g.,* Act of Mar. 10, 1887, tit. 38, § 2, 1887 Ariz. Rev. Stat. 383; Act of Mar. 20, 1989, ch. 92, §§ 1, 2, 1858 Ark. Stat. Dig. 621. 621-22; Act to Regulate the Interest of Money, ch. 31, § 2, 1850 Cal. Stat. 92 (1850); Act to Prescribe the Rate of Interest, § 3, 1861 Colo. Sess. Laws 45 (1861); Act to Legalize Ten Per Cent. Interest When It Is Agreed upon Between Parties, §§ 1, 2, 1857 Ill. Laws 45, 45-46 (1857); Act to Regulate the Interest on Money, ch. 72, §§ 1787, 1788, 1860 Iowa Rev. 316 (1853); Act Concerning the Rate of Interest, ch. 56, § 2, 1867 Mass. Acts 500 (1867); Act Fixing the Rate of Interest, ch. 56, § 1, 1860 Minn. Laws 226 (1860); Act of Mar. 24, 1845, ch. 88, §§ 1, 2, 1845 Mo. Rev. Stat. Neb. Laws 205, 205-6 (1855); Act in Relation to Money of Account and Interest, ch. 34, § 5, 1861 Nev. Sess. Laws 99, 100 (1861); Act in Relation to Interest, § 1, 1876 Utah Laws 170 (1869); Act to Regulate the Interest of Money, § 2, 1854 Wash. Laws 380 (1854).

when such states—like Arizona in *Daggs* and South Dakota (among other states) today—had no interest "rate expressed in the laws," and "allowed" lenders to charge any amounts to which a borrower agreed. *Id.*

In sum, section 85 would not achieve its broad purpose of protecting national banks against hostility in their home state unless "interest" is defined to mean all charges for the use, detention, or forbearance of money. Petitioner does not, and could not, argue that the word "interest" as used in section 85 has two different meanings, a broader meaning when the borrower resides in the bank's home state and a narrower meaning when she resides elsewhere. Nor can she properly argue that California has a stronger interest in regulating Citibank's charges than its home state does; on the contrary, as the Court held in *Marquette,* Congress, legislating against the background of a "developed interstate loan market," 439 U.S. at 317-18, chose to incorporate the interest law of the bank's home state and to require borrowers' states to "give way," *id.* at 318 n.31. Allowing a borrower's state to regulate one component of the bundle of charges that are otherwise beyond its reach would merely disrupt the interstate loan market that section 85 has fostered. *See Marquette,* 439 U.S. at 312 (declining to interpret "located" in section 85 in a way that would "throw into confusion the complex system of modern interstate banking").

C. The Office of the Comptroller of the Currency Has Consistently Interpreted Section 85 To Cover Late-Payment Charges

This Court has said more than once that when a court is required to construe a federal statute that has been the

subject of federal administrative interpretation, and the court "determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation." Instead,

> if the statute is silent or ambiguous with respect to the specific issue, *the question for the court is whether the agency's answer is based on a permissible construction of the statute.*

Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984) (emphasis added).

In particular, the Court has required such deference to the OCC on questions of interpretation of ambiguous provisions of the National Bank Act. *See NationsBank, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813-14, 816 (1995) (in defining term "insurance" as used in the Act, if "the administrator's reading fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment 'controlling weight' ").

The OCC is the exclusive supervisor of national banks. Few if any other fields of commerce are subject to the level of governmental supervision given to national banks.[36] This supervision runs to "all the affairs of the bank," 12 U.S.C. § 481, including consumer credit regulation.[37] Accordingly, to the extent that Congress has not itself directly spoken to the precise question at issue here—the meaning of "interest" in section 85—the OCC's interpretation

[36] *See, e.g.*, 12 U.S.C. § 481 (examination by OCC), § 1818(b)(1) (OCC enforcement authority regarding national bank violation of "any law"). State officials may not exercise any visitorial powers over a national bank, except in regard to certain state escheat laws. 12 U.S.C. § 484; 12 C.F.R. § 7.4001, as revised, 61 Fed. Reg. 4849 (Feb. 9, 1996).

[37] *See, e.g.*, OCC, *An Examiner's Guide to Consumer Compliance* (1993); *Comptroller's Handbook for National Bank Examiners* § 212 (credit card plans).

should be given "controlling weight." *See NationsBank*, 155 S. Ct. at 813-14.

In this case, two of the reasons for deferring to the expert agency are present in especially strong form. First, bank loan charges can and should—given a well-functioning market—take many forms, and the OCC's expertise in the mechanics and economics of lending is therefore crucial in sorting out which charges should count as "interest." Second, both banks and state governments have asked for and relied on the OCC's views.

On February 9, 1996, the OCC, following notice-and-comment rulemaking procedures, published an extensive set of rules interpreting various provisions of the Act. *See* 61 Fed. Reg 4849 (1996). Among them was a rule to be codified at 12 C.F.R. § 7.4001, which reads in pertinent part as follows:

> (a) *Definition.* The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, *late fees*, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

61 Fed. Reg. at 4869 (emphasis added).

The OCC's Federal Register statement concerning this regulation described it as intended to codify past "interpretive positions," 61 Fed. Reg. at 4858, and that description is accurate. For example, in a letter issued on February 17, 1995, the OCC's Chief Counsel, responding to a bank request, expressed the "opinion of the Office of the

Comptroller of the Currency" that late fees are "interest" governed by section 85:

> By its terms, section 85 is broadly written to apply to all interest charged as compensation for a loan. The National Bank Act was an expansively written statute designed to be an outline for a new national banking system. The Act did not contain a specific definition of the term "interest" and the term "interest" did not have any single narrow definition in the judicially-made law of that time. In general, the term was understood to include all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." Congress intended for the term "interest" in section 85 to be understood broadly to include any kind of lending charge allowed to state lenders in order to achieve Congress' goal of putting national banks on at least as strong a footing as the most favored lender subject to state control.[38]

Specifically with respect to late fees, the Chief Counsel stated:

> Credit card late fees are increased charges to borrowers who engage in delinquent payment behavior in order to compensate the bank for . . . increased lending costs and risks . . . . [They] are in addition to the basic monthly percentage finance charge on the account, and they represent an increased lending charge applicable when the customer retains the bank's money beyond the agreed upon date of payment. Accordingly, they are "interest" under the classic definition articulated in *Brown* [*v. Hiatts, supra*] and similar cases . . . .[39]

Prior OCC statements are in accord, as the Chief Counsel's letter itself recites at length. For example, responding in 1980 to a request from the Pennsylvania At-

[38] Julie L. Williams, OCC Chief Counsel, Interpretative Letter No. 670, [1994-1995 Transfer Binder] Fed. Banking L. Rep. ¶ 83,618, at 71,834 (Feb. 17, 1995).

[39] *See id.* at 86,696.

torney General, the OCC stated that Pennsylvania could not limit credit card annual fees charged by out-of-state national banks because such charges are "interest" governed by section 85 and the law of the bank's home state.[40] In 1992, the OCC advised a bank, in response to its query, that Iowa law could not limit an out-of-state national bank's "charges for late payment," again because such payments are "interest" for section 85 purposes.[41] This conclusion echoed advice given directly to the State of Iowa in 1988 specifically with respect to Citibank's "late fees, charges for [insufficient funds checks], and cash advance fees," all of which the OCC said are "interest" covered by section 85.[42]

Petitioner argues (Br. 27-28), citing *Adams Fruit Co. v. Barrett*, 494 U.S. 638 (1990), that the OCC is not entitled to deference because there has been no "congressional delegation of administrative authority." That argument is entirely wrong: the OCC has the power to supervise national banks to assure their compliance with, among

[40] *See* Letter from Richard V. Fitzgerald, Director, OCC Legal Advisory Services Division 3-4 (Nov. 24, 1980) (R. App. B).

[41] Letter from William P. Bowden, Jr., OCC Chief Counsel, 1992 WL 136390 (OCC), at *1, 3-4 (Feb. 4, 1992) (citations omitted).

[42] *See* Robert B. Serino, Deputy Chief Counsel (Policy), Interpretive Letter No. 452, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,064 (Aug. 11, 1988). *See also, e.g.*, Letter from Kenneth W. Leaf, OCC Chief National Bank Examiner 2 (Feb. 13, 1974) (section 85 governs "'all reasonable and necessary charges incurred in connection with the making, closing, disbursing, expending, readjusting or renewing of . . . loans'") (citation omitted) (R. App. C); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 10, 1961) (service charges) (R. App. D); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 1, 1956) (fees for expenses) (R. App. E); Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) (delinquency charges) (R. App. F); Letter from R.B. McCandless, Deputy Comptroller of the Currency (Sept. 3, 1947) (service charges) (R. App. G); Letter from J.L. Robertson, Deputy Comptroller of the Currency (Feb. 4, 1946) (set-up charges, collection charges) (R. App. H).

other provisions, section 85. *See* p. 36, *supra.* In *NationsBank*, the Court deferred to the OCC's interpretation of another section of the National Bank Act, not because of any such express delegation of interpretive authority but because the OCC is " 'charged with the enforcement of the banking laws to an extent that warrants the invocation of [the deference] principle with respect to [the OCC's] deliberative conclusions as to the meaning of those laws.' " *NationsBank*, 115 S.Ct. at 813 (*quoting Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 403-04 (1987), and *Investment Co. Inst. v. Camp.*, 401 U.S. 617, 626-67 (1971)).

Petitioner also accuses the OCC of taking inconsistent positions and asserts that, accordingly, the OCC's views "do not warrant any deference." (Br. 27-29). Even if the premise were true, the conclusion would be false: an agency's present views are entitled to deference even if there have been revisions. *NationsBank*, 115 S. Ct. at 817; *Good Samaritan Hospital v. Shalala*, 113 S. Ct. 2151, 2160-61 (1993). The touchbstone, as always, is the reasonableness of the agency's determinations. *See id.*

In any event, the OCC's views have in fact been consistent over a long period.[43] Petitioner's primary evidence (Br. 28) to the contrary is a single 1964 letter attached to her brief at Appendix B; that letter does not even refer to section 85 and, according to the OCC itself, was concerned with the interpretation of state law, not section 85. *See* Julie L. Williams, OCC Chief Counsel, Interpretive Letter No. 670, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-618, at 71,837 n.13 (Feb. 17, 1995).[44] The California Supreme Court was entirely correct in concluding (P.A. 28 n.13) that this letter was not concerned with the meaning of "interest" in section 85. Petitioner offers no evidence at all to support her assertion that the OCC held a view contrary to its present view for "twenty-four (24) years." (Br. 28).

[43] Petitioner asserts (Br. 29 n.13) that the OCC described its regulation as effecting a "significant change," but her quotation is misleading. The OCC's regulations have been changed only in that they now specifically address an issue previously addressed only in OCC letter interpretations. The OCC's Federal Register notice makes it clear, 60 Fed. Reg. at 11929, that the OCC did not consider the codification to represent a change in the OCC's legal views.

Petitioner also cites the 1988 OCC letter to Iowa, opining that Citibank's late charges *are* "interest" within the meaning of section 85, and argues that this letter impeaches the 1995 Chief Counsel's letter and the 1996 regulation because it follows a somewhat different analytical path to the same conclusion. (Br. 28). But while its analysis has naturally matured with further consideration, the OCC has never adopted any conclusion other than that section 85 authorizes a national bank to collect late fees at any rate, flat or otherwise, permitted by the laws of its home state.

D. DIDA and TILA Are Irrelevant to the Definition of "Interest" in Section 85

Petitioner contends that the legislative history of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") demonstrates that section 85 was not intended by Congress to define "interest" to include post-maturity charges. (Br. 42-43). Petitioner claims that DIDA is relevant because section 521 through 523 of that statute parallel the language of section 85 for federally insured state-chartered banks, thrift institutions, and credit unions. (Br. 43-44).

The argument based on sections 521 through 523 of DIDA does not make sense. (P.A. 31). Congress' words in those provisions are essentially identical to section 85,

[44] Read most naturally, the 1964 letter says only that the charges in question were allowed in addition to the percentage rate authorized by the state laws referred to in the first paragraph of the letter.

and thus nothing in their statutory language is helpful in interpreting section 85. Moreover, there is no pertinent legislative history from the 1980 enactment of these provisions. If these provisions have any relevance, it is that when Congress re-codified section 522 of DIDA in 1989, without changing its language, the pertinent House Report did not confine the scope of that provision to percentage-based interest rates but instead described the statute as applying to all "loan-related charges." H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1, at 343 (1989).[45]

Petitioner also relies on the legislative history of section 501 of DIDA, 12 U.S.C. § 1735f-7a(a)(1), a provision that deregulated rates for all lenders on purchase money mortgages for homes. (Br. 43 & n.1). Petitioner says that, while section 501 deregulated "interest," it did not deregulate late charges. The argument fails on at least two grounds. First, contrary to petitioner's contention, the language of the statute says plainly (and somewhat redundantly) that it is deregulating everything: "the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved." 12 U.S.C. § 1735f-7a(a)(2). Second, section 501 of DIDA, which has no relationship to any provision in the National Bank Act and was enacted more than 115 years later, cannot possibly be understood as enunciating the intention of the 1864 Con-

[45] DIDA also included a section, codified at 12 U.S.C. § 86a, that paralleled section 85 with respect to certain agricultural and economic loans for all lenders. *See* Pub. L. No. 96-399, § 324(b), 94 Stat. 1614, 1648 (1980), *amending* Pub. L. No. 96-221, §§ 511, 512, 94 Stat. 132, 164 (1980). *See generally* 12 U.S.C.A. § 86a note. Revisiting that section a few months later, Congress enacted a definition clarifying that "interest" includes all compensation for a loan "however denominated." The legislative history is explicit that this definition was Congress' attempt to make sure that the ordinary meaning of interest, including all compensation, was clear; it did not purport to be changing anything. *See* 126 Cong. Rec. 16, 112 (1980) (Statement of Senator Proxmire, Chairman of the Senate Banking Committee). Section 86a is now sunsetted.

gress that adopted section 85.[46] *Central Bank v. First Interstate Bank*, 114 S. Ct. 1439, 1452 (1994). *See Greenwood Trust Co., supra*, 971 F.2d at 830 n.10.

Petitioner also refers to the exclusion of late charges from the definition of "finance charge" in "Regulation Z," 12 C.F.R. §§ 226.1 to 226.30 (1993), under the Truth-in-Lending Act ("TILA"), 15 U.S.C. §§ 1601 *et seq.*, as support for her argument that late charges should be excluded from the definition of "interest" in section 85. (Br. 46 n.25). There is, however, no relationship between TILA and the National Bank Act in scope, substance, terminology, history, or purpose. In any event, contrary to petitioner's suggestion, Regulation Z does not exclude late charges from any definition of "interest" and does not set any restrictions on what charges may be collected. Regulation Z merely prescribes the format in which credit charges, including late fees, must be disclosed. It separates certain items, including "charges for actual unanticipated late payment" from the definition of "finance charge" (a term given a special definition), to make them more apparent to consumers and not because they are outside the domain of interest. *See* 12 C.F.R. § 226.4(c). Each charge listed under section 226.4(c), including late-payment charges, would presumably be within the definition of "finance charge" but for the explicit exclusion. (P.A. 33-34).

II. SECTION 85 PRE-EMPTS CALIFORNIA LAW UNDER THE CIRCUMSTANCES OF THIS CASE

This case turns on a question of statutory interpretation: whether the term "interest" as used in section 85 of the National Bank Act includes charges imposed by Citibank for the late payment of credit card balances. If it does, then California law, to whatever extent it purports to limit such charges, is pre-empted. There is no separate issue of pre-emption theory or "federalism" in this case.

[46] Section 528 of DIDA is explicit that a national bank may charge any rate allowed by section 85 or by any provision of DIDA. Pub. L. No. 96-221, § 528, 94 Stat. at 168.

This Court has said consistently that "the purpose of Congress is the ultimate touchstone of pre-emption analysis."[47] That is, the ultimate question is whether the congressional purpose was to pre-empt state law under the circumstances at issue. Here, that question can be fully answered in three steps. First, as Citibank has shown, when Congress used the term "interest" in section 85, its purpose was to cover a range of charges for borrowed money that would include the charges at issue. Second, as petitioner nowhere disputes, Congress surely intended "interest" in section 85 to have the same meaning whether the loan at issue is intrastate or interstate. This meaning of "interest" is a federal question that does not depend on the borrower's state of residence or its law. Third, as this Court held in *Marquette*, when Congress said that a national bank "may take . . . interest at the rate allowed by the laws of [its home] State," its purpose was that a national bank be empowered to do so notwithstanding any contrary policy of a borrower's state, whose law "must, of course, give way to the federal statute." 439 U.S. at 318 n.31. *Cf. Barnett Bank v. Nelson*, No. 94-1837, slip op. at 5 (U.S. March 26, 1996) (finding "irreconcilable conflict" between federal statute providing that national banks "may" sell insurance and state statute forbidding them to do so; state statute is therefore pre-empted).

Petitioner argues that the "presumption against pre-emption" cuts across all this and requires a "crystal clear statement" (Br. 13), lacking in section 85, before the section can be read to pre-empt California's supposed "historic police power" to regulate late-payment charges of out-of-state national banks. But, first, this Court's cases require no such "crystal-clear statement": the presumption against pre-emption is merely one guide to discerning the purpose of Congress, of greater weight in some

[47] *E.g., Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992); *FMC Corp. v. Holliday*, 498 U.S. 52, 56-57 (1990); *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 176 (1989).

cases than others, and capable of being overcome by other evidence.[48]

Moreover, there is no significant state interest that would support a presumption against pre-emption here. First, as the Court noted in ***Marquette***, borrowers have always been free to obtain credit out-of-state, and under historic principles (in 1864 and before), such loans were customarily regulated by the state law of the lender, not of the borrower.[49] Second, states have never had the

[48] *New York State Conference v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1676 (1995) (reciting the presumption but only as one factor in determining congressional intent); *United States v. Bass*, 404 U.S. 336, 349 (1971) (same). Congressional intention to displace state law "may be evidenced in several ways." *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). *See, e.g., Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 382 (1992) ("Pre-emption may be either express or implied, and is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose"). This Court has often found pre-emption by simply construing a statute to determine what Congress intended, without looking for anything like a "crystal-clear statement." *E.g., Barnett Bank v. Nelson*, No. 94-1837 (U.S. March 26, 1996) (finding pre-emption based on language, structure, and purpose of National Bank Act); *American Airlines, Inc. v. Wolens*, 115 S. Ct. 817, 823 (1995) (finding pre-emption after considering both language and purpose of statute); *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 839-40 (1995) (finding "broad" pre-emptive effect after considering language, background, structure, and purpose of statute).

[49] Under mid-nineteenth century conflict-of-laws principles governing contracts, the principle of *lex loci contractus* governed interest charges; that is, the law governing the rate of interest was the law of the state where the agreement was made. *See M'Queen v. Burns*, 8 N.C. (1 Hawks) 476 (1821); *Turpin v. Povall*, 35 Va. (8 Leigh) 93 (1837); *Houghton v. Page*, 2 N.H. 42 (1819). Moreover, courts rejected claims of usury on interstate loans, under the so-called "validating principle," if the lending charges were permitted under the laws of *either* the borrower's home state or the state in which the bank was located. *See Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1864); Story, *Commentaries on the Conflict of Laws* § 296, at 382 (6th ed. 1866); 2 Parsons, *Law of Contracts* 583-84 (1866).

power to regulate the overall cost of credit charged to their residents by out-of-state national banks. Under section 85, as interpreted in ***Daggs*** and ***Marquette***, a national bank located in a state that imposes no ceiling has always been able to charge a California borrower any amount of interest to which the borrower agrees; given that, any California stake in barring or limiting flat late fees would be highly attenuated at best. Third, the State interest asserted here (notably, by petitioner and not the State involved) cuts directly against the "most favored lender" purpose of section 85, and in that posture is not entitled to any presumption of Congressional deference. *See Barnett Bank v. Nelson*, slip op. at 7 ("In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, *or to impair significantly*, the exercise of a power that Congress explicitly granted") (emphasis added).

Of course, a state that wants to assure that a state-blessed package of terms will be available to its residents can do so. It can authorize lenders located in that state to lend only on specified terms (and to advertise that they conform to state requirements). What it cannot do, and has not been able to do since before 1864, is prevent its residents from searching elsewhere (physically, telephonically, electronically, or through the mails) and agreeing to terms that they find there and prefer—such as a lower annual percentage rate on timely paid balances in exchange for an agreement to pay late charges if they default.

This case is thus quite unlike cases in which a federal statute is alleged to pre-empt a power inherent in state sovereignty, *e.g., Department of Revenue v. ACF Indus.*, 114 S. Ct. 843, 851 (1994) (state taxing power), or to replace state regulation of matters of local concern, *e.g., Cipollone*, 505 U.S. at 516 (health and safety).

In such cases, this Court has explained, Congress "should not lightly be taken to have significantly changed the federal-state balance." ***United States v. Bass***, 404 U.S. 336, 349 (1971); ***see also Gregory v. Ashcroft***, 501 U.S. 452, 460-61 (1991).

No such "change[] [in] the federal-state balance" is at issue in this case. The National Bank Act did resolve one of the major federal-state economic issues of the nineteenth century (whether there would be national banks), but the national banks it created were from the start "instrumentalit[ies] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." *Marquette*, 439 U.S. at 308 (*quoting Davis v. Elmira Savings Bank*, 161 U.S. 275, 283 (1896)). In section 85, Congress acted primarily to protect these federal instrumentalities by giving them the rights of the "most favored lender" in their home states. That choice of home-state law to measure the federal rights of new federal instrumentalities did not deprive borrowers' states of any power they had ever had. That, no doubt, is why in *Marquette*, where the Court held that section 85 pre-empted the core of the borrower's state's usury law, the Court did not even mention any presumption to the contrary. ***See also Barnett Bank, supra***, slip op. at 6 (Court has historically "interpret[ed] grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but ordinarily pre-empting, state law"; state law pre-empted in absence of " 'indication' that Congress intended to subject that power to local restriction"; no mention of presumption against pre-emption).

Finally, Citibank wholeheartedly agrees with petitioner that "federalism counts in section 85." Section 85 makes brilliant use of a federal system to promote a national economy. Although the Civil War Congresses were not noted for their concern for states' rights, the 1864 Congress was wise enough to reject proposals for uniform national regulation of interest charged by national banks,

and to adopt instead a system that incorporates the laws of the home states of the national banks and thus reflects and adjusts to local economic conditions, permitting interstate competition that benefits both consumers and the national economy.

As the Court recognized in *Marquette*, the debates that led to this conclusion "occurred in the context of a developed interstate loan market," 439 U.S. at 317. Congress understood that borrowers could borrow across state lines if more attractive terms were available elsewhere, and designed section 85 to fit (and foster) an economy in which they would do so, so that capital could readily move across state lines.

Congress did this quite deliberately, as evidenced by the debate in the House of Representatives as to whether section 85 should prescribe a uniform rate of interest for national banks [50] or allow states to establish the lending rates for those banks "whether the established rate be fixed with or without contract." *See* Cong. Globe 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Price). The congressmen in favor of establishing a uniform rate of interest sought to take the management of lending charges away from the states.[51] Those opposed to the uniform rate, including Representatives Cole and Higby and Senator Conness of California, primarily represented Western states that, to attract capital, allowed borrowers to agree to any interest they found acceptable.[52] Ultimately, Congress elected not to establish a uniform rate but instead to allow each state to set those rates for banks located within its borders. In this respect, this is not a traditional pre-emption case, because within the federally defined rubric of "interest" Congress has not imposed a federal rate of interest, but instead has simply chosen one state's law of the "interest allowed" over that of another state.

The result of section 85, together with developments that have made the mechanics of lending more efficient, has been an enormous success. As the Federal Reserve Board has reported to Congress, thousands of lenders now compete nationwide to offer Mastercard, Visa, and other bank credit cards, and their competition is "intense." FRB Report 6 & n.8. These lenders compete, as the Board has noted, by offering different packages of terms. FRB Report 6 n.8, 7-8. This means that different borrowers can find packages that suit them. In particular, the ability of some lenders to offer packages that include late-payment charges means that borrowers who use their credit cards for borrowing and regularly pay on time can reduce their finance charges (because the costs that late payers impose on the lender can be collected instead from late payers) and borrowers with weak credit histories can get credit that would not otherwise be available. Robert E. Litan, *The Economics of Credit Cards*, at 7-8 (Jan. 1993).

[50] As it was originally presented to the 38th Congress, section 30 of the National Bank Act of 1864 provided "[t]hat every association may take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at the rate of seven per centum per annum." H.R. 333, 38th Cong., 1st Sess. (1864).

[51] *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Stevens); *id.* (remarks of Rep. Kellogg); *id.* at 1376 (remarks of Rep. Kasson); *id.* at 2123 (remarks of Sen. Pomeroy).

[52] *See* Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Kellogg) ("I am aware of the plea that is made use of in some portions of the Western States, that we must permit high rates of interest in order to draw capital into the country."); *id.* at 1376 ("'Why is it that we of the West to-day find capital concentrated in New York? Because capital goes where it can be best placed. . . . You cannot get a uniformity of system from the complex systems existing to-day under the various laws of the several states."); *id.* at 1352-53 ("It is well known to all gentlemen here that interest varies in different localities. . . . It is frequently an advantage for persons to pay [24 percent] and even a higher rate of interest. The persons who propose to borrow money are probably as competent to judge of the advantage it will be to them as the community in general.") (remarks of Rep. Cole); *id.* at 1374 (1864) (remarks of Rep. Higby); *id.* at 2124 (remarks of Sen. Conness).

The ultimate result is that credit cards are now involved in an estimated two-thirds of all United States retail transactions. *Id.* This case, like *Marquette*, must of course be decided as a matter of statutory construction, not economic policy, but it is appropriate to note that the result of the balkanization petitioner seeks—essentially the erection of a protective barrier against interstate competition in lending by national banks—would be inefficient, costly, and highly disruptive of a smoothly functioning and competitive system of credit.

CONCLUSION

The decision of the California Supreme Court should be affirmed.

Respectfully submitted,

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APPENDICES

APPENDIX A

STATUTORY PROVISIONS

12 U.S.C. § 85. Rate of interest on loans, discounts and purchases

Any association may take, receive, reverse, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Reviewed Statutes. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may b the greater, and such interest may be taken in advance, reckoning the day for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

APPENDIX B

[Nov. 24, 1980]

Mr. David Rosenberg
Deputy Attorney General
Commonwealth of Pennsylvania
Bureau of Consumer Protection
333 Market Street, 19th Floor
Harrisburg, Pennsylvania 17101

Dear Mr. Rosenberg:

This is in response to your letter of September 9, 1980, which asks for a legal opinion regarding charges a national bank may make in relation to its credit card operations when dealing with customers who are Pennsylvania residents. Specifically, you ask whether a national bank may charge its Pennsylvania credit card customers "annual fees for the privilege of using a . . . credit card," notwithstanding the prohibition of such charges in Pennsylvania's Goods and Services Installment Sales Act ("Act"), 69 P.5. §§ 1101-2303. I have given the question serious consideration and have concluded that while the Act's prohibition probably should apply to national banks "located" (*See* 12 U.S.C. § 22 (Second)) in Pennsylvania which have issued credit cards to Pennsylvania residents, there are serious objections to applying the prohibition to national banks "located" in other states which have issued credit cards to Pennsylvania residents.

The Act provides a comprehensive scheme for the regulation of retail installment sales and revolving retail installment accounts. The Act's jurisdictional sweep is wide; it purports to apply to any "retail installment contract, contract, retail installment account, installment account, or revolving account" established by a Pennsylvania resident regardless of where the transaction originated or was consummated, so long as either an offer, acceptance, or invitation for an offer takes place within Pennsylvania.

69 P.S. § 1103. The Act, *inter alia,* regulates all charges that can be made in connection with installment sales or installment accounts. Such charges are referred to throughout the Act as either "service charges" or the "time price differential," which are defined as follows:

> "Time price differential" or "service charge" means the amount however denominated or expressed which the retail buyer contracts to pay or pays for the privilege of purchasing goods or services to be paid for by the buyer in installments; it does not include the amounts, if any, charged for insurance premiums, delinquency charges, attorney's fees; court costs, collection expenses or official fees. Wherever either of such terms is required to be used under the provisions of this act the other may be used interchangeably.

69. P.S. § 1201(10).

The "service charges" which may permissibly be charged by the issuer of a credit cards are:

> (a) On the outstanding balance, one and one-quarter percent (1¼%) per month.
>
> (b) A minimum service charge of seventy cents . . . per month may be made for each month if the service charge so computed is less than that amount; such minimum service charge may be imposed for a minimum period of six months . . . .

69 P.S. § 1904. *See also, id.* at § 1501 (charges on installment sales). Under § 906 of the Act, the above-quoted "service charges" are established as the upper limit of what may be charged: "The service charge shall include all charges incident to investigating the making of the retail installment account. No fee, expense, delinquency, collection or other charge whatsoever shall be taken, received, reserved or contracted by the seller or holder of a retail installment account. . . ." 69 P.S. § 1906.

The "service charge" fixed by the Act for retail installment accounts supersedes the rate of interest fixed by Pennsyl-

vania's Banking Code for "revolving credit plans," which is 12%. 7 P.S. § 309(a). *See, Acker v. Provident National Bank*, 512 F. 2d 729 (3d Cir. 1975). Your question, to repeat, is whether the limitation on "service charges" set forth in 69 P.S. §§ 1904 and 1906 are applicable to national banks with credit card customers who are residents of Pennsylvania.

Generally, the rates which national banks may charge on loans are governed by 12 U.S.C. § 85. Under that section, a national bank is permitted to charge interest "at the rate allowed by the law of the State . . . where the bank is located. . . ." In *Marquette National Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978), the Supreme Court interpreted the above-quoted language to mean that "a national bank [is] located for purposes of [§ 85] in the state named in its organization certificate" under 12 U.S.C. § 22 (Second). *Id.* at 310. As construed by *Marquette*, therefore, § 85 is a choice-of-law provision under which the amount to be charged on a national bank loan is governed by the law of the state where the bank is located, regardless of the "contacts" which the loan has with any other state and irrespective of the statutory provisions of another state.

In light of an analysis of the Act's provisions in the context of § 85's language and purpose, it is my opinion that a national bank located outside of Pennsylvania is not subject to the Act's limitations on "service charges." This is because what the Act refers to as "service charges" are, in substance, interest rates for purposes of § 85. As noted previously, the Act's definitional section states that the terms "service charge" and "time price differential" are to be used interchangeably. Indeed, the Act's terminology seems to have been adopted solely as a method of escaping the ancient "time-price doctrine," under which usuary laws do not apply to credit sales. *See* Comment, *The Pennsylvania Goods and Services Installment Sales Act: One Man's Interest, Another Man's Service Charge*, 77

Dick. L. Rev. 493, 506-508 (1973). Since §§ 1904 and 1906 set forth interest rate limitations, they are inapplicable to national banks located outside of Pennsylvania.

While no court has attempted to define "interest" in the context of a statute resembling Pennsylvania's Act, there is a federal circuit court decision which points to the conclusion reached herein. In *Northway Lanes v. Hackley Union National Bank*, 464 F. 2d 855 (6th Cir. 1972), a suit under 12 U.S.C. § 86 against a national bank located in Michigan, Michigan law provided that lenders in the state could generally charge a maximum of 7% interest and prohibited such lenders from charging their loan customers more than $15 for additional expenses in connection with the loan. Savings and loan associations, however, were permitted to charge such costs to their customers. In order to reach its holding that the defendant bank could take advantage of this law under the "most favored lender" doctrine, the court, of necessity, had to characterize these "costs" as being the equivalent of interest.

Under *Northway Lanes*, therefore, all charges permitted or prohibited by state law in connection with particular types of loans may be defined as "interest." Since, as established *supra*, a national bank must look only * to the law of the state where it is located in order to determine the charges it may exact in connection with its loans, a national bank located outside of Pennsylvania need not abide by Pennsylvanias' implied prohibition of "annual fees."

Of course, if the state where the national bank is located prohibits annual fees, such prohibition would be applicable to the national bank's credit card transactions with

* It should be noted that under 12 U.S.C. § 85, a national bank need not necessarily be governed by the provisions of state law. Section 85 provides national banks with the alternative of charging the highest rate fixed by the law of the state in which it is located, 1% above the Federal Reserve discount rate on 90-day commercial paper, or, in the case of business and agricultural * * * loans in excess of $1000, 5% above the discount rate.

Pennsylvania residents. It is interesting to note that often a state legislature, in creating interest rate "packages," will compensate for a low interest rate ceiling by allowing a lender to charge specified fees. Thus, in *Marquette, supra,* while Nebraska permitted its lenders to charge 18% on credit card loans under $1,000.00, but prohibited such lenders from charging annual fees, Minnesota, "[t]o compensate for the reduced interest," permitted banks "to charge annual fees of up to $15 for the privilege of using a bank credit card." *Marquette, supra,* 439 U.S. at 302-304. If the Act's prohibitions were to apply to out-of-state national banks, a national bank could be faced with the anomalous situation of being a "least favored lender," since it might be governed by the lower interest rate ceiling of the state where it is located but still not be permitted to levy the annual fees allowable under that state's laws. This anomalous situation could not have been intended by the authors of the National Bank Act.

As far as a national bank located in Pennsylvania, the Act, on its face, constitutes "the law[] of the state . . . where the bank is located," and would be applicable to it in the absence of a Pennsylvania statute setting a higher permissible interest rate for loans of this type made by a different class of lender. *See, e.g., United Missouri Bank of Kansas City v. Danforth,* 394 F. Supp. 774 (W. D. Mo. 1975) (national banks in Missouri not governed by that state's Retail Credit Sales Act, since they may charge higher rates under Missouri's Small Loan Company Act); 12 C.F.R. § 7.7310.

I trust this has been responsive to your inquiry.

Very truly yours,

[signed]
Richard V. Fitzgerald
Director
Legal Advisory Services Division

APPENDIX C

THE ADMINISTRATOR OF NATIONAL BANKS
Washington, D.C. 20220

[CC Logo]
Office of the
Comptroller of the Currency February 13, 1974

Dear Mr. ——————

We have your letter of January 9, 1974, with reference to 12 U.S.C. 85.

In response to your first question, national banks may charge interest either on the basis of the limits established by state law, *or* at a rate of 1% above the discount rate on ninety-day commercial paper in effect at the district Federal Reserve Bank. Traditionally, national banks have set their interest rates in accordance with state law, but as a result of the recent rise in the discount rate an increasing number have been switching to the discount rate formula set forth in 12 U.S.C. 85. National banks may use this method of computing interest regardless of state law, and the fact that state banks may be at a competitive disadvantage is irrelevant.

Nevertheless, as your second question indicates, the notion exists that national banks may charge only what state banks may charge. This idea apparently originated with the language:

> . . . except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for [national banking] associations organized or existing in any such State under this chapter.

The language quoted above does not limit national banks to the same rates permitted to state banks. It must be read in conjunction with the first part of the statute (ignoring, for the moment, the discount rate formula which was added in 1933). When the two parts are read

together, it becomes clearer that Congress wished to allow national banks to take interest at the general rate (i.e., the "contract rate") established by state law, but if state banks were permitted, through special statutory exceptions to the general rate, to charge a higher rate (the words "a different rate" mean "a higher rate"), then national banks shall also be allowed to charge the higher rate. Therefore, national banks are permitted to charge *at least as much* as state banks and *more* if other lenders within the state are permitted more. This is because "National banks have been National favorites." *Tiffany* v. *National Bank of Missouri,* 85 U.S. (18 Wall.) 409, 411-412, 21 L. Ed. 862 (1874), a case which recognizes the critical importance placed by Congress upon the establishment of a banking system whose principal function, initially, was to circulate a uniform national currency to replace the then-existing tender issued by state banks.

The answers to your first two questions are discussed more fully in an enclosed letter dated October 2, 1973, to a bank in your state.

In your third question, you ask whether national banks must adhere to a state law prohibiting state banks from charging interest or fees (closing fees, etc.) above a certain rate while exempting other state licensed institutions from such restrictions. Consistent with our views set out above, national banks may *charge interest* or *levy other fees* at the maximum rate permitted by state law to *any* competing state-chartered or licensed lending institution. See Interpretive Ruling 7.7310, 12 C.F.R. 7.7310, and *Northway Lanes* v. *Hackley Union Nat'l Bank*, 464 F. 2d 855 (6 Cir. 1972). In *Northway Lanes,* the court held that since savings and loan associations in Michigan were allowed by state law to charge a specified rate of interest on real estate loans, and in addition thereto "*all reasonable and necessary charges incurred in connection with the making, closing, disbursing, expending, readjusting or renewing of* [*said*] *loans* . . .", national banks in Michigan were also permitted to levy the same "reasonable and necessary charges." Therefore, state laws which limit such fees for state banks are not applicable to national banks if other state licensed lending institutions are permitted higher charges.

Your fourth question asks: When the law of the state says that the assessments on loans made by savings and loan associations shall not be deemed usury, although in excess of the legal rate of interest, is a national bank limited to "a rate not exceeding 7 percentum, or 1 percentum in excess of the discount rate on ninety-day commercial paper . . . , whichever may be the greater . . .?" The answer is in the negative. Your question is obviously brought on by the language in 12 U.S.C. 85 which states that "When no rate is fixed by the laws of the State," national banks may charge 7% or 1% in excess of the commercial paper rate. This provision has been interpreted by the Supreme Court to mean that the 7% limit is applicable only when local law forbids the taking of *any* interest, hardly a likely eventuality in any state. The effect of the court's restrictive opinion is to read the 7% limitation out of the statute. See *Daggs* v. *Phoenix Nat'l Bank,* 177 U.S. 549 (1900); Shanks, Special Usury Problems Applicable to National Banks, 87 *Banking Law Journal* 483, 486 (1970).

The curious result in *Daggs* was reaffirmed in *Hiatt* v. *San Francisco Nat'l Bank,* 361 F. 2d 504 (9 Cir. 1966). There, the plaintiff also urged that the 7% limit in 12 U.S.C. 85 was applicable to a national bank loan, and sought to distinguish *Daggs* on the ground that California law had not spoken in any manner with respect to her loan, whereas in *Daggs* the Territory of Arizona had specifically provided that the parties could contract for any rate. The Ninth Circuit found the plaintiff's argument "technically forceful" but rejected her plea on the basis of *Daggs.* Since certiorari was subsequently denied by the Supreme Court, 385 U.S. 948 (1966), it would appear that the 7% limit in 12 U.S.C. 85 can be ignored.

You also inquire whether a national bank that establishes its interest rate on the basis of 12 U.S.C. 85's discount rate formula must lower its interest rate when the discount rate falls. This question is answered in the negative, since it is our view that a rate which is legal when agreed upon remains valid throughout the term of the contract. A discussion of this subject and the exception for refinancing is contained in an enclosed letter dated November 13, 1973 to the Mississippi Bankers Association.

Finally, you ask whether under 12 U.S.C. 86 the applicable penalty is "a forfeiture of the entire interest paid or payable *plus* twice the total interest paid *or* plus twice the amount of interest paid which is in excess of the lawful rate?" We have not done any extensive research on this question and must therefore refer you to the annotations under 12 U.S.C. 86. However, on the authority of the cases listed in Note 117 thereunder, it would seem that the recovery is double the amount of all interest paid down to the time of trial, and not merely double the excess over the legal rate. At least one court has confined the recovery to double the amount of interest paid during the two year period prior to suit. *First Nat'l Bank of Birmingham v. Daniel*, 239 F. 2d 801, 805 (5 Cir. 1956).

A copy of the decision in *National Central Bank* v. *Heindel*, a summary of which is reported at CCH Federal Banking Law Reports ¶ 95,799, is enclosed. Our Litigation Section will send you a copy of the Comptroller's brief in the *Northway Lanes* case and bill you for the same pursuant to 12 C.F.R. 4.17(d).

We trust the above is responsive to your inquiry.

Very truly yours,

KENNETH W. LEAF
Chief National Bank Examiner

Enclosures
Barrett 2/10/74

APPENDIX D

[Jun. 10, 1961]

We have received your letter of June 7, 1961 in which you ask if a national bank located in West Virginia may make a service charge on a loan in addition to 6% interest, which is the maximum permitted under West Virginia law, except under the Small Loan Act.

The rate of interest which a national bank may charge on a loan is governed by Section 85 of Title 12, U.S.C., which provides that if the rate which may be charged by state banks is limited by the laws of the State, the rate so limited shall be allowed for national banks existing in such State. However, in enacting Section 85, Congress intended that, with respect to interest charges, national banks shall have the same powers as *any* competing State lending institution. Therefore, where state law permits a higher-than-ordinary rate of interest to be imposed on specified classes of loans by lending institutions, national banks may also charge the higher rate. With the foregoing exception, national banks located in your State would be limited as to the charges it may make on a loan to the same charges permitted state banks organized under the law of the State.

Very truly yours,

/s/
W. M. TAYLOR
Deputy Comptroller of the Curreny

APPENDIX E

[Jun. 1, 1956]

In a separate communication to this office accompanying report of examination of your bank completed April 25, 1956 the examiner advises us that the usual rate of interest charged by your bank on a certain type of small loans is 8% per quarter.

As you know, Section 5197 of the Revised Statutes (12 U.S.C. 85) provides, in substance, that a national bank may charge interest at the same rate allowed by state law to competing institutions. This office has ruled, in Par. 9510 of the *Digest of Opinions*, that where state law permits higher than ordinary rates of interest for certain specified classes of loans, a national bank making such loans is subject to all limitations of substance imposed by the state law which authorizes the higher rate.

Our information is that a licensee under the Small Loan Act of Oklahoma may charge 10% per annum, plus an agreed fee for expenses not to exceed 5% and in no event to exceed $15 not oftener than every six months, plus 2% per month, not to exceed $2, for certain additional expenses.

Since we are interested in any contingent liability which might accrue to your bank under Title 12 of the United States Code, Section 86, as the result of illegally excessive interest charged, we shall appreciate your advising us whether you have obtained the opinion of counsel as to whether your schedule of interest charges is within the maximum rates allowed by statute in the State of Oklahoma.

Very truly yours,

(Signed) W. M. Taylor
Deputy Comptroller of the Currency

APPENDIX F

[Feb. 24, 1955]

Reference is made to the question submitted at the recent examiners' meeting by National Bank Examiner L. Dale Shaffer, relating to charges made by some banks in Pennsylvania when the payments on installment loans are extended.

The Pennsylvania Small Loan Act, known as Act No. 70, as amended, may be found in Purdon's Pennsylvania Statutes Annotated, Title 7, section 819-1001, subparagraph A(4). The Act specifies that the permissible charge on an installment loan is a principal amount not exceeding $3,500, covering a period not exceeding three years, shall be at a rate not exceeding $6 per $100 per annum upon the original face amount of the loan for the entire period of the loan, which may be collected in advance. The Act also provides:

> ". . . No additional amount shall be charged or contracted for, directly or indirectly, on or in connection with any such installment loan, except the following: (a) Delinquency charges not to exceed five cents for each dollar of each installment more than fifteen days in arrears: Provided, That the total of delinquency charges on any such installment loan shall not exceed fifteen dollars, and only one delinquency charge shall be made on any one installment; . . ."

Under the above quoted exception in the law, state banks in Pennsylvania, and therefore national banks under the authority contained in Section 5197 of the Revised Statutes (12 U.S.C. 85) may make a delinquency charge within the permissible limits when monthly installment loan payments are extended.

Very truly yours,

(Signed) L. A. Jennings
Deputy Comptroller of the Currency

APPENDIX G

Loans; Proceeds subject to Limited Monthly Withdrawals; Interest Charged as Usurious

[Sep. 3, 1947]

This is in reply to your letter of August 14, 1947 relating to an arrangement whereby a borrower from your bank deposits the proceeds of his loan in a special account, from which he may withdraw not in excess of a specified amount monthly. You inquire whether such a plan is in violation of the laws governing national banks.

There is no legal prohibition against a national bank making a loan in periodic instalments instead of in a single lump sum, although the latter is the usual practice. Likewise, it is not illegal to accomplish the same end by placing the entire amount of a loan in a special account out of which the borrower may make limited periodic withdrawals.

However, under the latter arrangement the bank must be careful that the total charges imposed upon the borrower (whether such charges are described as "interest", "service charges", or otherwise) do not exceed the legal rate of interest. As you know, section 5197 of the Revised Statutes (12 U.S. Code 85) limits the interest charges of national banks to the rate "allowed by the laws of the State * * * where the bank is located, * * * except that where by the laws of any State a different rate is limited for banks organized under State laws", national banks located in that State may also charge such higher rate.

The courts have held that if a borrower is required to leave part of the proceeds of a loan on deposit with the lender, the transaction is usurious if the interest paid amounts to more than the legal interest on the sum *actually available* for use by the borrower. *Planters' National Bank of Virginia v. Wysong & Miles Co.* (1919)

177 N.C. 380, 99 S.E. 199; Annotation, 12 A.L.R. 1422. The law of Maryland fixes 6% per annum as the maximum lawful rate (2 Anno. Code Md. (1939) Art. 49, sec. 1). Accordingly, it would be usurious to "lend" $600 for one year on condition that the borrower leave $300 on deposit with the lending bank throughout the year, and to charge 6% on the entire $600 (i.e., $36 interest). Since the borrower only has the use of $300 for one year, a charge of $36 is actually at the effective rate of 12% per annum, which is usurious.

The situation is similar where a loan on $600 is made for one year and placed in a special deposit which is available to the borrower in instalments of $50 each month, the entire $600 being repayable at the end of the year. In this case also the borrower has the use of an average sum of $300 for one year, and the interest rate may not lawfully exceed 6% on such sum actually available to him, rather than on the full amount of the nominal loan of $600, which he would have the use of only in the last one of the twelve months.

In view of the foregoing, the bank should make certain that the total charges exacted on loans of the type described shall not exceed the maximum lawful rate of 6% on the average amount actually in the hands of the borrower during the life of the loan. Assuming that there is no violation of law in this respect, we see no objection to your bank's handling loans in the manner outlined in your letter.

Very truly yours,

(Signed) R. B. McCandless
Deputy Comptroller

APPENDIX H

[Feb. 4, 1946]

Reference is made to the request for a ruling in the confidential section of the current report of examination of the ————, with respect to the bank's system of charges on small installment loans, and the question of whether those charges may be in excess of the limits prescribed in recent Pennsylvania legislation. You advise the charges include a "setup charge" of \$3 per loan, a collection charge of 10¢ per installment, and 6% interest on the original amount financed. Thus, in financing a 12-month loan of \$50, the charges added would be \$7.20. You state the matter was discussed with the cashier, and it was sugested that he should consult his attorney.

In view of the provisions of Section 5197 of the Revised Statutes (U.S.C. title 12, sec. 85) it is clear that if the interest charged by a national bank is in excess of the amount allowed by State law to be charged by State lending agencies which compete with national banks, it would be regarded as usurious. The attached photostatic copy of a letter dated July 6, 1945, directed to all State banking institutions by the Secretary of Banking of Pennsylvania together with the bulletin containing the text of the new Pennsylvania Small Loan Act for banks, effective April 6, 1945, and the explanatory comments contained therein, indicates to us that under this interpretation of the State law by the State banking authorities the charges exacted by the ————, in the example given by you, would be considered usurious. You should advise the bank to this effect and suggest they obtain a copy of the letter of July 6, 1945 with attached bulletin for the consideration of their attorney. The bank's attorney should also give consideration to the comments contained in the cases of *Kelter v. American Bankers' Finance Co.*, (Pa. 1932) 160 Atl. 127, and *Dickey v. Bank of Clarksdale*, (Miss. 1938) 184 So. 314.

Very truly yours,

(Signed) J.L. Robertson
Deputy Comptroller.

(17)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

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REPLY STATEMENT

Respondent ("Citibank") has abandoned much of the lower court's reasoning by denying that the first two issues accepted for review are even at issue. There can be no doubt, however, that those issues remain critical. Petitioner maintains that a national bank's rate authority is bounded by the plain, common law meaning of "interest" and "rate" in 12 U.S.C. § 85 (1994) ("§ 85"). She contends that such a boundary is necessary to avoid an unconstitutional delegation of limitless national lawmaking authority to a bank's home state. In response, Citibank and the Office of the Comptroller of the Currency ("OCC") feign agreement that "interest at the rate" must be defined by federal law, recognizing that only Congress can preempt state law. *See* Resp. Brf. 14 n.5; U.S. Amicus Brf. 23. But Citibank then argues that § 85's rate authority extends to all charges and terms allowed by a bank's home state that have an economic connection to the bank's rate. *Cf.* Resp. Brf. 22, 48-49 (home state determines charges included in "rate").[1] Citibank contends that such broad authority is necessary to avoid potentially hostile state laws that could set a low interest rate while allowing other charges for other lenders. So the question that combines all three issues here is whether § 85 simply adopts the allowed "rate" of "interest" (even an unlimited rate) of a bank's home state, as urged by petitioner, or operates as a broader federal choice of law provision that federalizes practically all of the statutory and decisional law of a bank's home state that has any effect on the bank's loan yields. *See* Colorado, *et al.* Amicus Brf. 2-3 (arguing that § 85 is a boundless federal choice of law provision).

Though § 85 clearly displaces state regulation of interest "*rates*," *see Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 319 & n.31 (1978), Congress has not clearly stated that the statute also preempts nondiscriminatory

---

[1] In effect, Citibank wants to have it both ways – an all-inclusive federal definition that depends on the home states of banks to determine the charges included in the interest rate and, in turn, the preemptive scope of § 85.

state contract laws limiting default penalties such as Citibank's credit card late fees. Section 85 uses the phrase "interest at the rate" to refer to charges that, at the outset, can be, in the words of the statute, "reckoned [to] the days" and to the amount of the debt. 12 U.S.C. § 85. Even as detention charges, the late fees here are not charges that are calculable at the outset based on the time and the amount of the late payment. Accordingly, § 85 does not preempt California's contract laws limiting Citibank's late fees.

Once "interest at the rate," by any rate measurement – state or federal – is conceded to have an objective federal definition, settled principles of federalism define the preemptive scope of the term. *Bowen v. American Hosp. Ass'n*, 476 U.S. 610, 644 & n.33 (1976). These fundamental principles override any exaggerated estimates of the liability at stake here, particularly given the 19.8% and even higher interest rates (JA 53) Citibank is permitted to charge and the fact that most states already permit some limited form or amount for contractual late fees.[2] Because Congress retains the authority to expand the powers of national banks to export non-interest charges limited only by federal standards, and because only then will the political safeguards of federalism be brought into focus on the question of all credit-related terms, "interest at the rate" should be construed to mean precisely what it says – a charge measurable at the outset by a rate based on time and the payment owed. *See Barnett Bank v. Nelson*, No.

[2] The contention that it would be inefficient or disruptive to subject banks to the non-interest contract laws of a borrower's state is belied by respondent's own amici. For example, the briefs of both the Affinity Marketing Group, et al., and the American Bankers Association, et al., in support of respondent, make it clear that card issuers routinely tailor their credit card packages to unique and even individual conditions or preferences. *See* Affinity Amicus Brf. 2; ABA Amicus Brf. 23. Although a borrower's state may choose to regulate non-interest charges to channel competition and comparative shopping towards the important pricing term of the interest rate, that decision does not interfere in any way with an out-of-state bank's right to charge the highest *rate* allowed by its home state. Indeed, nothing prevents Citibank in this case from charging a higher time-based rate to late payers than to timely payers. Congress also reasonably could have concluded that only the central price component, the interest rate, deserved specific attention in the NBA.

94-1837, 64 U.S.L.W. 4161, 4164, 4166 (U.S. Mar. 26, 1996) (requiring notice so affected parties can focus on the likely effects of proposed legislation). Given the absence of any indication that Congress intended to displace broadly not just the rate ceiling of the borrower's state but also virtually all of that state's loan-related contract laws with another state's rate definition or ceiling, the California Supreme Court's ruling must be reversed.

ARGUMENT

I. THE MOST FAVORED LENDER DOCTRINE DOES NOT OBLITERATE THE PRINCIPLES OF FEDERALISM.

Underlying all the arguments of respondent and its amici is an unconstitutional expansion of the most favored lender doctrine. Though most favored lender status protects national banks from state discrimination with respect to interest rates, it does not displace the individual states' authority to enact and enforce evenhanded contract, tort and consumer protection laws regulating loan charges or terms other than interest rates. Instead of being paramount to all other considerations, the doctrine operates in conjunction with federalist principles. *Cf.* Cong. Globe, 38th Cong., 2d Sess. 2124 (1864) (Remarks of Sen. Trumbull) ("This provision of the bill [section 30] is not an interference with the States, but on the other hand an agreement with the States.").

Rejecting this point, Citibank premises its main argument on the mistaken belief that "interest at the rate" should be defined by the economic consequences to the bank. Citibank suggests that Congress used this phrase to authorize as "interest" all additional administrative and collection charges imposed by a bank. *See* Resp. Brf. 14, 30. Citibank then suggests that the charges exportable as part of its allowed rate must be defined with reference to the "laws of the home state of the national bank" so interest can be "adjusted to local conditions." Resp. Brf. 48. In effect, all of these arguments improperly condition either the meaning of "interest" or the definition of "rate" on the laws of the bank's home state.

"Congress did not intend such an improbable result." *First Nat'l Bank v. Dickinson*, 396 U.S. 122, 133-34 (1969).

The clear language of the statute ordinarily determines legislative intent; policy perceptions do not. *West Virginia Univ. Hosp. Inc. v. Casey*, 499 U.S. 83, 99-100 (1991). Here, even Citibank agrees that "interest at the rate" means, at a minimum, a charge measurable ("reckon[ed]") at the outset by time and the unpaid balance. *See* 12 U.S.C. § 85. No purpose of the National Bank Act ("NBA") requires a different reading. Nor would any Congressional purpose be frustrated by the same literal reading this Court required in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 410 (1874). In fact, this Court has rejected virtually the same "bundle" or "package" policy arguments that Citibank asserts throughout its brief to justify a broader interpretation (Resp. Brf. 12, 35, 50). *See New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1677 (1995) (rejecting package preemption).

Contrary to respondent's speculative claims of potential rate discrimination, it is clear that Citibank derives its ability to charge the type of late fees at issue here not from § 85, but from 12 U.S.C. § 24 (1994) ("§ 24"). That statute empowers national banks to enter into contracts and to impose incidental charges "subject to law." *Id.* While § 24 might preempt a state law that prohibited or "significantly interfered" with a bank's power to make contracts, neither Citibank nor the OCC has contended or could contend that California's contract laws regulating the late fees here prohibit or "significantly interfere" with that ability.[3] *Cf. Barnett Bank*, 64 U.S.L.W. at 4163 (state law prohibiting any exercise of express power is preempted). Absent the type of "significant interference"

[3] Such an argument would be absurd, for it would necessitate a vast federal common law of banking contracts that would displace countless state laws impacting upon ordinary loan agreements, including the statute of frauds and even the Uniform Commercial Code. *See O'Melveny & Myers v. Federal Deposit Ins. Corp.*, 114 S. Ct. 2048, 2053-55 (1994); *Cf. Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976) (agency cannot enlarge statute).

reflected in *Barnett Bank, see id.*, state contract laws, including conflict of laws principles, must apply to national banks. *See id.*; *see also First Nat'l Bank v. Kentucky*, 76 U.S. (9 Wall.) 353, 362 (1870). Indeed, the banks themselves have historically depended on these very state contract laws to give effect to all their transactions.

As the Solicitor General now admits, wholly apart from § 85 and the most favored lender doctrine, the NBA already prevents a bank's home state from discriminating against the bank (U.S. Amicus Brf. 8, n.1). *See Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 247-49 (1944); *Sherman v. Citibank (S.D.), N.A.*, 143 N.J. 35, 68-70, 668 A.2d 1036, 1052-53 (1995), *petition for cert. filed*, No. 95-991, 64 U.S.L.W. 3439 (Dec. 21, 1995). Thus, Citibank's argument that, if "interest" does not include the late fees at issue here, South Dakota could permit its state-chartered banks to assess such late charges without extending that same privilege to national banks is wrong. Regardless of § 85, a national bank can charge sum-certain late fees in its home state as a matter of non-discriminatory state contract laws.

If the NBA was intended to displace all state contract and tort laws that might have an indirect economic impact on the terms or pricing of loan agreements by national banks, established principles of federalism required Congress to put the states on notice of that intent. *See Gregory v. Ashcroft*, 501 U.S. 452, 464 (1991). Without such notice, the political safeguards of federalism cannot function, particularly where, as here, there is no direct conflict between a federal power and a state rule. In fact, the state rule (Cal. Civ. Code § 1671) is not a rate ceiling, but rather an evenhanded fee limitation that is completely consistent with the federal rate law and is imbedded in the general contract and common laws of the state. Petitioner's analysis, then, besides incorporating federalist principles, coincides with the most favored lender doctrine.[4]

[4] Citibank and its amici mistakenly insist that a borrower's state has little interest in regulating contractual credit terms offered in the state by out-of-state lenders. *See, e.g.*, Resp. Brf. 12. Congress and countless courts have rejected that

Citibank incorrectly dismisses the important issues of federalism in this case. Those issues are highlighted by this Court's consideration of the preemptive scope of the federal discount rate measurement for "interest" in *Marquette*. *See* 439 U.S. at 318 n.31 ("[t]o the extent the enumerated federal rates of interest [discount rate plus 1% or 5%] are greater than permissible state rates, state usury laws must, of course, give way"). The scope of preemption for the federal discount rate measure in § 85 cannot depend in any way on the law of the bank's home state, for that law itself would be preempted. Just as the presumption against preemption must confine the preemptive scope of the discount rate alternative, so too must it confine the preemptive scope of the state rate alternative. *Cf. National Bank v. Johnson*, 104 U.S. 271, 277-78 (1881) (discount interest and loan interest are the same). As we describe below, established principles of federalism limit the preemption effected by either rate measure to the rate ceiling of the bank's or the borrower's state.

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very position. For example, in enacting the RIEGLE-NEAL INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT OF 1994, PUB. L. NO. 103-328, § 114, 108 STAT. 2367, Congress expressly found that the customer's state has a significant interest in regulating consumer protection and redlining issues. *See* H.R. CONF. REP. NO. 651, 103d CONG., 2d SESS. 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2039, 2068-74; *see also Sherman*, 143 N.J. at 68-71, 668 A.2d at 1052-53; *Mazaika v. Bank One (Columbus), N.A.*, 439 Pa. Super. 95, 115, 653 A.2d 640, 650 (1994), *alloc. granted*, 659 A.2d 557 (Pa. 1995). In addition, Congress expressly provided in that Act that branches of out-of-state banks will be subject to and controlled by the laws of their host states with respect to non-interest consumer protection laws, thus precluding application of the laws of the parent bank's state. *See* 12 U.S.C. § 36(f)(1) (Supp. 1995); *see also* H.R. CONF. REP. NO. 651 *supra* at 13, 53. Similarly, federal and state courts have uniformly found that a borrower's home state has a compelling interest in regulating the credit terms offered in that state by solicitations originating out-of-state. *See, e.g.*, *Aldens, Inc. v. Packel*, 524 F.2d 38, 43, 48-49 (3d Cir. 1975), *cert denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. LaFollette*, 552 F.2d 745, 750-51 (7th Cir.), *cert. denied*, 434 U.S. 880 (1977); *Aldens, Inc. v. Ryan*, 571 F.2d 1159, 1161 (10th Cir.), *cert. denied*, 439 U.S. 860 (1978); *Turner v. Aldens, Inc.*, 179 N.J. Super. 596, 602, 433 A.2d 439, 442 (App. Div. 1981).

II. CITIBANK'S CLASSIFICATION OF ALL LENDING CHARGES AS INTEREST IGNORES THE COMMON LAW OF PENALTY CHARGES.

When a statute is unambiguous, the plain English meaning of its language ordinarily controls. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242-43 (1989). In the absence of specific definitions, unique constructions are irrelevant because the words used are presumed to have a common law meaning. *See United States v. Texas*, 507 U.S. 529, 534 (1993).

Here, § 85 plainly provides that only "interest at the rate" allowed by the bank's home state may be exported. Citibank's late fees cannot be interest because they lack the two fundamental characteristics of interest – they are not and cannot be computed ("reckon[ed]") at the outset based on either the *amount of time* the money has been withheld by the borrower or *the amount owed* by the borrower. As petitioner demonstrated in her opening brief (*see* Pet. Brf. 30-39), interest on a loan detention includes components of both the amount owed and the time for which it is owed. For the late fees challenged here, neither component is present. Thus, a borrower who owes $50 and a borrower who owes $5,000 are both charged the same late fee. Similarly, a late borrower is charged the same late fee on a thirty-day revolving account whether he is one day or twenty-nine days late.[5]

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[5] Contrary to respondent's suggestion, petitioner does not object to the imposition of Citibank's late fees simply because they are expressed in terms of a flat fee rather than as a percentage. Whether the absolute dollar figure charged is expressed as a flat fee or as a percentage figure is not dispositive. It is because the late fees at issue do not bear any relation to the payment owed or to the amount of time the money has been withheld that they are *not* interest. Respondent further mischaracterizes petitioner's position by casting it in terms of an objection to the excessive amount of the late fee here. Although the fee far exceeds the bank's cost, that is not why it falls outside of § 85. Whether the type of late fee here was one dollar or one hundred dollars, the principle that the late fees at issue bear no relation to the amount of time the money was retained or the amount of money owed remains the same. Moreover, the OCC's assertion that the late fees here are monthly charges (U.S. Amicus Brf. 15) is incorrect. The late fees are imposed for any failure to pay within 25 days of the due date. (JA 56). Certain of the fees (JA 74) also are

Citibank states that there is no "logical or economic reason" single-sum penalty charges should not be considered interest. Resp. Brf. 24. To the contrary, one such reason is identified in respondent's own brief: if single-sum default charges were "interest," it would "not be possible to determine whether a certain late charge exceed[ed] a given percentage ceiling until *after* the charge [was] actually incurred." *Id.* (emphasis added). A national bank must be able to determine whether a charge is excessive *before* the charge is imposed so it can avoid the severe penalties of either forfeiture or double the amount of interest collected pursuant to 12 U.S.C. § 86 (1994) ("§ 86").[6] Indeed, this Court has emphasized that §§ 85 and 86 must be construed "strict[ly]" and "literal[ly]" to avoid the imposition of penalties on national banks. *See Tiffany*, 85 U.S. at 410; *Keppel v. Tiffen Sav. Bank*, 197 U.S. 356, 362 (1905). Congress could not have intended to establish a system in which national banks and their borrowers could not predict or prevent usury violations until *after* the usurious charges were imposed. Congress must have intended instead a system in which state common law would regulate single-sum penalties as contractual liquidated damages, not as "interest" or usury. Respondent's implausible analysis does not prove a contrary or broader intention. *See* Pet. Brf. 36-37.

In her opening brief, petitioner cited myriad of cases applying contract principles to penalty charges and distinguishing those principles from statutory interest and usury standards. *See, e.g., New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) ("[a lender] cannot recover special damages for the detention of money beyond what the law allows as interest"); *see also United States v. Texas*, 507 U.S. at 536.

In response, Citibank attempts, without success, to distinguish a few of the many cases holding that additional

imposed twice per billing period, which violates California's current law, Cal. Fin. Code § 4001.

[6] This point distinguishes virtually all of Citibank's cases. Many of those state cases involve either forbearance charges or closed-end loans, where, unlike here, both lender and borrower could determine compliance with the usury ceiling *before* the charges were imposed. *See, e.g., Craig v. Pleiss*, 26 Pa. 271 (1856).

contract penalties are *not* interest. Citibank says, for example, that *United States v. Texas* should be ignored because it did not involve the NBA or address "interest" in the same context as this case. In fact, *United States v. Texas* specifically examined the common law of prejudgment interest, which is the same law that defines damages for delay in the payment of money. *See* 507 U.S. at 536. In reviewing that common law, this Court observed that late fees and penalties are "more onerous than the common law" of prejudgment interest. *See id.* at 536. Neither *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177 (1873), nor *Shoemaker v. United States*, 147 U.S. 282 (1893), relied upon heavily by Citibank and its amici, address these additional sum-certain charges imposed beyond the contract interest rate to punish or deter a late payment.

More important, the *Brown* definition of "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention," 82 U.S. at 185, advanced by Citibank, simply does not answer the definitional question presented here. Unlike *United States v. Texas*, *Brown* did not consider the common law scope or meaning of "damages for [the] detention [of money]." Since *Piaggo* and *United States v. Texas* addressed that very common law, and found that late fee penalties are beyond the concept of interest as damages, it explains the very general and otherwise unhelpful definition of *Brown*. Accordingly, *Piaggo* and *United States v. Texas* are both relevant and instructive.

Citibank and the OCC also incorrectly state that the term "rate" in § 85 is synonymous with the word "amount." *See* Resp. Brf. 24; U.S. Amicus Brf. 13. In fact, § 85 uses "rate" to mean the "reckoning [of] the days for which the note, bill, or other evidence of debt has to run." 12 U.S.C. § 85. Unlike the word "amount," the word "rate" has a ratio relationship to time. This is further underscored by the fact that section 30, 13 Stat. 108 (1864) (now divided into §§ 85 and 86) clearly uses the different terms "interest at the *rate*" and "twice the *amount* of interest paid" to refer to different things. Interest "*rate*" refers to the bank's compensatory charge, while "*amount* of interest" refers to the aggregate sum

of money improperly collected by the bank.[7] Although the word "rate" in different contexts can mean different things, in the context of interest and lending, it means a "ratio of the interest to the principal for each unit of time." JUSTIN A. MOORE, HANDBOOK OF FINANCIAL MATHEMATICS 2 (1929). Hence, the strained contention of Citibank and the OCC that "rate" means "amount" is unsupported by the statutory usage.

Misdirecting the Court to an expansive construction of "rate," respondent and the OCC misstate the holding of *Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904). *See* Resp. Brf. 4; U.S. Amicus Brf. 16. In *Donnell*, this Court focused on the effect that the bank's compounding of interest had on the actual "rate" charged by the bank. *See* 195 U.S. at 374 ("[t]he rate of interest . . . is greater when [the bank] is allowed to compound"). Because the compounding of interest within one year caused the bank's rate to exceed the state's *per annum* rate ceiling, the Court upheld the finding of usury. Given that holding, the Court disregarded the bank's monthly loan advance charge, stating "[t]he suggestions as to the 12 percent charge on overdrafts do not seem to us to need answer." *Id.* at 374. Citibank and the OCC misinterpret this passage as a finding that penalties are "interest." But this Court never even addressed that question, since all the parties in *Donnell* recognized that penalties (in contrast with agreed loan advances) are not interest within the meaning of § 85.[8] Hence, *Donnell* actually supports petitioner, not Citibank.

Citibank's heavy reliance on *Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549 (1900), for a broad definition of "rate" (*see* Resp. Brf. 24) is equally misplaced. In that case, Arizona

[7] Obviously, it would be impossible for a borrower to recover as a penalty for usury twice "the [rate] of interest" paid to a national bank, for that penalty does not indicate any base for the measurement.

[8] *See Citizens' Nat'l Bank v. Donnell*, 72 S.W. 925, 933 (Mo. 1903) (observing that the monthly loan advance charge was not a penalty because the bank had "consented to the overdraft"). Unlike the bank in *Donnell*, respondent here has not consented to a cardholder's late payment. It has instead defined a late payment as a contractual default for which it will not forbear even if the late fee is paid. (JA 58).

allowed the parties to "agree in writing for the payment of any *rate* of interest." 177 U.S. at 554 (emphasis added). Because Arizona did not "fix" a rate ceiling for written agreements, Daggs argued that the federal rate of 7% provided the rate-cap for the Phoenix National Bank. This Court held that the proper focus was not on a rate "*Fixed by the laws*" of the Territory but on the rate "*allowed by the laws*" of that Territory. *Id.* at 555 (emphasis in original). Since Arizona allowed any *rate* agreed to in writing, the national bank was also authorized to charge any "*rate*" in its written contracts. *See id.*

Contrary to Citibank's contention, *Daggs* is limited to a time-based *rate*. While the *Daggs* Court distinguished *National Bank v. Johnson*, 104 U.S. at 278, *see* 177 U.S. at 556, it did not cast any doubt on the holding in *Johnson*, as later reiterated in *Evans v. National Bank*, 251 U.S. 108, 111 (1919), that § 85 adopts only the maximum allowed interest "*rate*" of a bank's home state. As the Court in *Evans* explained, § 85 does not adopt all of the loan yield laws of the bank's home state that might have an indirect impact on the rate. Compare *Evans*, 251 U.S. at 111-114 (majority opinion) with *id.* at 115-120 (dissenting opinion); *Travelers*, 115 S. Ct. at 1676-80 (rejecting package preemption based on charges "related to" a plan or rate).

While Citibank and the OCC deny that the first two issues addressed by petitioner are even at issue, their reading of *Daggs* makes clear that those issues are pivotal. Inasmuch as Citibank concedes that its home state's law cannot define "interest at the rate" in § 85, *Daggs* must be confined to the federal meaning of "interest" and "rate." A contrary reading would effectively delegate unlimited power to determine the preemptive scope of § 85 to the different statutory and decisional laws of each of the fifty states. Congress could not have intended that result. *See Dickinson*, 396 U.S. at 133-34; *Seattle Trust & Sav. Bank v. Bank of California, N.A.*, 492 F.2d 48, 50-52 (9th Cir.), *cert. denied*, 419 U.S. 844 (1974).

Urging a broad definition, respondent also contends that "interest" has different meanings in different contexts. But that begs the question. When Congress used the term "interest

at the rate" in § 85, it could not have intended for banks and state legislatures to pick and choose, at their convenience, what the term means. When the words are read together in the context of the statute, "interest at the rate" means an agreed-upon charge calculable ("reckon[ed]") at the outset by time and the payment owed. The only charges that can constitute "interest" then are those that can be determined from the beginning to bear some ratio relationship to the amount and duration of the debt.[9]

In sum, Citibank's "all lending charges" theory conflicts with the plain meaning of § 85, misconstrues the common law, and overstates the purposes of § 85 and the most favored lender doctrine.[10] More important, Citibank's proffered definition is far broader than even the agency definition for which Citibank requests judicial deference. As we detail below, the definition currently espoused by the OCC, though somewhat narrower, also violates § 85 and is unworkable.

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[9] Here, Citibank continues to collect precisely the same rate of interest as it would otherwise collect from a timely paying cardholder. Unlike a percentage, time-based fee on a precomputed closed-end loan, Citibank's open-end late fee is not in any way a compensatory charge calculable at the outset as a rate based on time and the payment owed. Even the $6.00 plus a separate .65% charge for Citibank's Preferred Cards (*see* JA 74) is noncompensatory because it is calculated based on the entire outstanding balance and not on the actual payment amount that is late.

[10] The OCC's interpretation also fails to recognize the "*id quod interest*" principle, which measures "the difference between the creditor's current position and what it would have been if the loan had been timely and fully repaid." *Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986). An example of "*id quod interest*" is found in *Brown v. Hiatts*, 82 U.S at 185 (interest accrues or runs). This detention interest (prejudgment interest) has never included additional sum-certain penalties like Citibank's late fees. *See United States v. Texas*, 507 U.S. at 536; *Library of Congress*, 478 U.S. at 322 ("Private-sector decisions, when they adjust for the time of payment, grant interest or a delay factor, but not both."). In fact, a lender was not allowed to recover more than "*id quod interest*" for a loan default. *Piaggio*, 83 U.S. at 386. Accordingly, the OCC's assertion that the late fees here are "interest" ignores relevant precedent and misinterprets the plain meaning of § 85.

III. THE REGULATORY MATERIALS CITED BY CITIBANK DO NOT WARRANT JUDICIAL DEFERENCE.

Both Citibank and the OCC urge this Court to defer not to an agency rulemaking pursuant to § 85 but to an agency interpretation issued over 130 years after the statute was passed. The OCC's very recent interpretation of "interest" must be rejected because it is not a permissible construction of the statute, it exceeds the agency's jurisdiction, and it conflicts with basic preemption principles.

The OCC does not attempt to justify its new interpretation based on any administrative expertise. Instead, the OCC acknowledges that defining interest is a straightforward question of statutory construction and that the primary reason for including "late fees and overlimit fees" as interest is that "[m]any courts interpreting 12 U.S.C. § 85 have concluded that various forms of non-percentage-based charges (including such items as late payment, overlimit, and annual fees) for the use of borrowed money fall within the scope of 12 U.S.C. § 85." 61 Fed. Reg. 4858-59 (Feb. 9, 1996) (Pet. Rep. Brf. App. A). Thus, in effect, Citibank and the OCC ask for deference to an agency position which is predicated almost exclusively upon the opinions of lower courts. Petitioner knows of no case – and especially not *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) – in which an agency has obtained deference on the basis that its decision reflects "current case law," 61 Fed. Reg. 4858.[11] Certainly no such deference is warranted here.

Petitioner has already shown that the plain meaning of the statutory term leaves no doubt about Congressional intent. The Court should not defer to an agency interpretation inconsistent with the plain meaning of the statute.

The OCC's recent interpretation is not a "permissible construction" because it is subjectively based on labels instead

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[11] Any deference to the Comptroller's current interpretation also must be discounted because it was a post-hoc, litigation-inspired reaction to ongoing credit card fee litigation, in which the agency participated as amicus on the side of the banks. *See Bowen v. Georgetown University Hosp.*, 488 U.S. 204, 212-13 (1988).

of substance. *See Chevron*, 467 U.S. at 863. The OCC has redefined "interest" broadly to include "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." 61 Fed. Reg. 4869. Purportedly based on this definition, the interpretation then subjectively categorizes various charges into "interest" and "non-interest." However, there is no rational basis for distinguishing the various charges the OCC has denominated interest ("numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees") from those charges it has denominated "non-interest" ("appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of an extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports"). *See id.* As these subjective categorizations make clear, the OCC, without any delegated authority or discernible standards to limit its subjective decisionmaking, has accorded itself boundless authority to expand or limit the meaning of "interest at the rate" in § 85.[12]

In particular, the agency's recent definition fails to provide any substantive, objective basis on which to distinguish "interest" from "non-interest" charges. Some of the OCC's non-interest fixed charges, such as closing fees for appraisal, document preparation and credit reports, are the kind of ordinary credit expenses which lower courts have treated as "interest." *See, e.g., Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 864 (6th Cir. 1972) (closing costs found to be "interest" in case where OCC appeared as

[12] Given the absence of any delegated authority or standards, the Court should reject the OCC's attempt to do through "interpretation" what the agency cannot do and has not done through formal rulemaking. Where, as here, Congress has not provided any guidelines or standards for determining the scope of federal preemption or for checking the exercise of delegated authority, the delegation is unconstitutional. *See Panama Refining Co. v. Ryan*, 293 U.S. 388, 418, 421 (1935). To avoid that result, "interest at the rate" should be read narrowly. *Cf. National Cable Television Ass'n v. United States*, 415 U.S. 336, 342 (1974) (construing statute "narrowly" to avoid unconstitutional delegation).

amicus curiae). In contrast, other charges the OCC now denominates as "interest," such as annual and payment system fees that are far removed from any actual extension of credit, traditionally have *not* been considered interest. *Cf. Milwaukee Brewery Workers' Pension Plan v. Jos. Schlitz Brewery Co.*, 115 S. Ct. 981, 988 (1995) ("In our view, one generally does not pay interest on a debt until that debt arises – that is to say, until the principal of the debt is outstanding"). Apart from elevating the label of a charge over the substance of that charge, there is no principled basis for the distinctions the OCC has drawn.

The omissions from the OCC's listing of "interest" further establish the unreasonableness of the OCC's interpretation of the statutory term. For example, the interpretation fails to address the important loan-related fees of prepayment penalties, attorneys' fees and court costs. If prepayment penalties, attorneys' fees and collection costs are not "interest," there is no principled basis for concluding that the late fees here are interest. *Cf.* 61 Fed. Reg. 11301 (Mar. 20, 1996) (OCC rule treating prepayment fees on mortgage loans as non-interest fees). Even worse, if prepayment penalties and other such charges are "interest," then national banks across the country will confront usury claims each time a prepayment penalty or attorneys' fee causes the rate charged by the bank to exceed the applicable rate ceiling in the bank's home state.

Another example of unreasonableness is found in the OCC's explanation of the "*[e]ffect on state definitions of interest*" in subparagraph (c) of the interpretation, 61 Fed. Reg. 4869. (*See* Pet. Rep. Brf. App. A). Both Citibank and the OCC have insisted that late fees must be "interest" because a contrary rule would allow states to discriminate against national banks by setting low percentage rate ceilings while allowing other lenders to charge late fees. Indeed, Citibank expressly describes "[t]he issue" as "whether flat charges for borrowed money are 'interest,' such that they count against [the home state's] 'rate' ceiling; if not, the state's ceiling could be evaded with impunity." Resp. Brf. 23. Subparagraph (c) of the OCC's interpretation, however, inconsistently provides that late fees are interest for the purpose of preempting

the contract laws of other states but should "not be treated as interest for purposes of evaluating compliance with state usury limitations, or [rate ceilings]" if the home state does not include late fees in calculating its maximum rate of interest. 61 Fed. Reg. 4869. Thus, the OCC's interpretation defines late fees as both "interest" and "non-interest" depending on the "rate" definitions of the bank's home state. *See id.* at 4858 (state law determines what lending charges are permitted). Presumably, this divergent, confusing and inefficient "effect on state definitions" would also apply to all the other fees the OCC has defined as "interest."

This inconsistent "effect" is equally unreasonable where a state's rate ceiling for all lenders includes more charges than the OCC's definition includes. For example, if a state's statutory ceiling embraces charges the OCC has now denominated as "non-interest," such as appraisal fees, a national bank in that state presumably would have to adjust the allowed ceiling by subtracting the appraisal fee component to arrive at the actual "rate" allowed in the state. Any different rule would have the "effect" of preempting the state's allowed *rate* with a federal non-interest charge even though Congress has expressly consigned the rate ceiling to state decisionmaking. Although there is no principled basis for treating a more inclusive state ceiling any differently from one that is less inclusive, for the OCC's interpretation to work in practice, the rate ceiling adjustment or "effect" would have to apply only in less inclusive states. Banks in the more inclusive states, therefore, effectively could ignore the home state's rate ceiling altogether because they could charge any amount for the non-interest fees. Of course, that results in the same low-ceiling/high fee problem the OCC and respondent inconsistently insist must be avoided with respect to late fees.[13]

[13] Presumably, the dual "interest"/"non-interest" effect described by the OCC is intended to account for those states with relatively low interest rate ceilings that do not consider late fees to be interest. *See, e.g.*, Letter to OCC from Senators Pryor and Bumpers (Pet. Rep. Brf. App. B). While the late fees would be federal "interest" in such states, under the OCC's interpretation they would not be interest within the meaning of the "rate" allowed pursuant to § 85 and, therefore, would not be counted against the state's rate ceiling as incorporated into § 85. In such states, subparagraph (c) apparently would allow a national bank to export both the rate ceiling *and* additional late fees. This effect violates § 85, for it overrides the "rate allowed by the laws of the State," and sets no limit on any of the fees exported by the bank, even though such fees may be separately regulated by the home state.

Subparagraph (c) is equally unworkable when national banks opt for the alternative § 85 rate of 1% over the federal discount rate. *See Marquette*, 439 U.S. at 318 n.31 (noting the preemptive effect of the federal rate option). While late fees and other fees *would not be counted* toward the rate ceiling if the bank's home state did not define "interest" to include these fees, according to subparagraph (c) they apparently *would be counted* toward the alternative federal rate ceiling. Banks opting for the federal rate would then have to either refrain from charging any other fees or create massive monitoring systems to ensure that any default fees charged did not cause the rate to violate the federal ceiling. Obviously, such an inconsistent scheme is neither uniform nor efficient from the banks' or the consumers' perspective. In short, whatever deference the Court might be inclined to afford the OCC in other circumstances, its lack of any rationale for the subjective labelling distinctions that it drew (and failed to draw) completely undermines its very recent position equating the late fees here with interest.

Apart from being unreasonable, deference is also inappropriate because Congress has directed the judiciary, not an executive agency, to interpret §§ 85 and 86. Unlike other cases calling for agency deference, this case involves "a pure question of statutory construction" that does not depend on any agency expertise or adjudicatory deliberation. *See INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 (1987). Petitioner has not challenged the general corporate powers of a national bank under the NBA. Rather, petitioner has questioned only whether evenhanded state contract laws that do not prohibit or even interfere with those powers, and, in fact, give life and substance to those very powers, may be enforced in ordinary transactions involving national banks just as they are enforced by the banks themselves. The OCC's recent interpretation

here is neither a safety and soundness rule, overriding all state limitations on credit-related fees, nor a corporate powers rule. Accordingly, it is the province and duty of this Court to say what the law is in this case.[14]

In response, both Citibank and the OCC, citing the OCC's general supervisory and enforcement authority, attempt to distinguish this Court's rejection of agency deference in the analogous case of *Adams Fruit Co. v. Barrett*, 494 U.S. 639 (1990). In *Adams Fruit*, the Court rejected a plea for deference to an interpretation by the executive department responsible for enforcement of the federal statute at issue. The Court observed that the statute expressly established the judiciary and not the executive agency as the adjudicator of rights arising under the statute, just as § 86 of the NBA establishes the judiciary and not the OCC as the adjudicator of rights under § 85. The Court in *Adams Fruit* reasoned that because Congress had established an enforcement scheme with direct recourse to the courts, it was inappropriate to consult executive interpretations to resolve ambiguities concerning the preemptive scope of the statute. *Adams Fruit*, 494 U.S. at 650-51. The same principles necessarily apply here.[15]

[14] The OCC's reliance on 12 U.S.C. § 93a (1994) for preemptive rulemaking authority here is misplaced. *See* U.S. Amicus Brf. 21. Section 93a was enacted in 1980 as part of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), Pub. L. No. 96-221, 94 Stat. 188. As noted in petitioner's opening brief, DIDA did not provide any notice to the states that their general contract laws would or could be overridden by federal administrative preemption of their states' statutory usury ceilings. *See* Pet. Brf. 42-43. By also authorizing the OCC to issue rules "to carry out the responsibilities of the office," 12 U.S.C. § 93a, Congress did not signal that the Federal-State balance could be "significantly changed" by OCC rulemaking. *See Bowen v. American Hosp. Ass'n*, 476 U.S. at 644 & n.33. Hence, unlike *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982), the political safeguards of federalism have never been brought to bear on the expansive interpretations advanced by respondent and the OCC here. Nor has Congress provided any standards to guide or limit the OCC's subjective interpretive authority. *Cf. National Cable Television Ass'n*, 415 U.S. at 342 (abjuring deference and construing statute "narrowly" to avoid delegation problems).

[15] The OCC's contention that 12 U.S.C. §§ 93 and 1818 vitiate the holding of *Adams Fruit* is incorrect. Section 93 authorizes the OCC to enforce the provisions of the NBA, but it does not provide any separate standards to guide that enforcement authority. Section 1818 is part of the Federal Deposit Insurance Act and addresses the OCC's power to terminate the charter of an insured depository institution. Neither section displaces the exclusive judicial forum chosen by Congress in §§ 85 and 86 for the construction of a bank's interest rate charges or provides any guidelines for or limits on the OCC's preemptive powers.

Finally, deference to the OCC's interpretation is inappropriate here because federal preemption is at issue. *Cf. Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 151-52 (1963) (reflecting concern for preemptive delegation); Laurence H. Tribe, American Constitutional Law § 6-26, 496-97 (2d ed. 1988) (analyzing *Florida Lime*). As the OCC concedes, deference to an agency opinion is proper only when the statute is "silent or ambiguous." *Chevron*, 467 U.S. at 843 ("If the intent of Congress is clear, that is the end of the matter"). *See* U.S. Amicus Brf. 11. When the statute is "silent or ambiguous," and does not otherwise provide standards for an agency to issue preemptive rules having the force of law, the presumption against preemption necessarily requires a finding that federal law does *not* preempt state law. *See Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (preemption, if it is intended, must be "clear and manifest"). Stated another way, when, as here, the statute does not set standards for agency preemption through rulemaking,[16] deference to a preemptive agency interpretation is misplaced,

[16] The OCC apparently believes that the notice requirements of 12 U.S.C. § 43 (Supp. 1995) are sufficient. Section 43 was enacted as part of the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 114, 108 Stat. 2367. Finding that the bank regulators were issuing overly aggressive opinions preempting state laws, Congress mandated in that Act that any opinion by the OCC that might have a preemptive impact must first be published for notice and comment and describe "each" state law likely to be affected. *Id.*; H.R. Conf. Rep. No. 651, *supra* at 55, 1994 U.S.C.C.A.N. at 2068-74. Section 43 did not, however, grant any new or additional power to preempt state law or set any standards for the preemptive decisions. *See id.* (the notice "process is not intended to confer upon the [OCC] any new authority to preempt or to determine preemptive Congressional intent"). Here, the OCC violated section 43 by failing to describe "each" state law likely to be preempted. *Cf.* 60 Fed. Reg. 11924, 11929 (1995) (notice of proposed interpretation that omits any description of "each" state law at issue).

since the very ambiguity that permits such deference proves that Congress had no clear and manifest intention to preempt non-conflicting state law.[17]

In sum, the OCC's unauthorized interpretation conflicts with Citibank's definition and is unreasonable. Petitioner's objective focus, in contrast, is supported both by the plain meaning of § 85 and the common law understanding of the phrase "interest at the rate." In the absence of any clear statements to the contrary, the presumption against preemption and the federalist design of the NBA require a narrow, plain English construction of "interest at the rate" in § 85.

CONCLUSION

For the reasons set forth above and in petitioner's opening brief, the judgment of the California Supreme Court should be reversed.

Dated: April 15, 1996

Respectfully submitted,

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[17] In any event, the OCC's recent interpretation cannot be given retroactive application to control the outcome of this litigation because Congress has not expressly granted to the OCC any authority to issue rules that bind retroactively. *See Bowen*, 488 U.S. at 208-09 (requiring an express grant of such authority).

REPLY APPENDIX A

61 Fed. Reg. 4858

Charging Interest at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrowers (Section 7.4001)

Under 12 U.S.C. 85, a national bank may charge interest at the highest rate allowed to competing lenders by the state where the bank is located without regard to the location of the borrower. Thus, the statute permits a national bank to "export" to customers in other states the rate of "interest" allowed by the state in which the bank is located. The proposal defined the term "interest" in 12 U.S.C. 85 to reflect current case law. The proposed definition also reflected OCC interpretive opinions on the types of fees and charges that are included and not included in the meaning of the term. The proposal provided non-exclusive lists of specific fees that are "interest" (for example, numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees) and that ordinarily are not "interest" (for example, appraisal fees, premiums and commissions on insurance guaranteeing repayment, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports).

Whether a particular fee or charge is properly characterized as "interest" subject to exportation has been the subject of litigation in a number of jurisdictions,[1] and the

[1] See, e.g., Smiley v. Citibank (South Dakota), N.A., 900 P.2d 690 (Cal. 1995), cert. granted, 64 U.S.L.W. 3500 (U.S. Jan. 19, 1996) (No. 95-860) (holding that the term "interest" as used in 12

OCC received many comments from parties on both sides of the issue. On one hand, certain consumer groups and attorneys representing class action suits opposed the proposal. These groups asserted that the proposed definition is contrary to the accepted meaning of the term "interest," and is contrary to consumers' interests. On the other hand, many national banks supported the proposal because it incorporates clear guidance on the OCC's position on the issue of what constitutes "interest" under 12 U.S.C. 85. The OCC believes that the Federal definition of "interest" and the components of interest in the proposal are both consistent with law and beneficial to national banks and their customers with respect to interstate lending operations.

The OCC also received comments from Arkansas trade associations and the Arkansas congressional delegation expressing concern that the proposed Federal definition of "interest" might be misinterpreted to require the inclusion of certain charges that are "interest" under the

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U.S.C. 85 encompasses late payment fees if such fees are allowed by a national bank's home state); see also Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992), cert. denied, 113 S. Ct. 974 (1993) (holding that the term "interest" as used in section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. 1831d(a)), a statute modeled on 12 U.S.C. 85, includes late payment fees; in construing the term "interest" in 12 U.S.C. 1831d(a), the court concluded that these parallel sections should be read in pari materia). Contra Sherman v. Citibank (South Dakota), N.A., No. A-102-94, 1005 WL 710414 (N.J. Nov. 28, 1995), pet. for cert. filed, 64 U.S.L.W. 3439 (U.S. Dec. 21, 1995) (No. 95-991) (holding that the term "interest" as used in 12 U.S.C. 85 does not include late payment fees).

Federal definition, but not so under Arkansas law, when calculating the maximum effective yield permitted by Arkansas law. The commenters noted that, if the OCC adopts this interpretation, some loans now acceptable under Arkansas usury law could be found to be usurious. The OCC agrees that the language of the proposal is potentially confusing and might be interpreted mistakenly to affect the definition of "interest" in the Arkansas usury law (which, for example, permits banks to charge late fees, but does not include those fees as "interest" in calculating the maximum effective yield).

The definition of interest in Sec. 7.4001 is intended to define "interest" for purposes of determining if a particular charge is subject to 12 U.S.C. 85. Charges that fall within the Federal definition of "interest" are subject to 12 U.S.C. 85 and its "most favored lender" and exportation rules. The fact that a charge is not labeled "interest" under a particular state law does not necessarily mean that it is impermissible, however.

Section 7.4001(b) clarifies that, under the ruling (and 12 U.S.C. 85), one looks to state law to determine what lending charges are permitted for the most favored lender, and thus, also for national banks under 12 U.S.C. 85. However, the Federal definition of "interest" generally does not affect state law definitions of "interest" or the manner in which state law calculates the amount of interest being charged. For example, if late fees are not interest under state law where the national bank is located but state law allows late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank could also charge the fees to its interstate customers because the fees are

"interest" under the Federal definition and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

The final ruling addresses the concern raised by the Arkansas commenters regarding the effect of the Federal definition of interest on state law. The OCC has added to Sec. 7.4001 a new paragraph (c) that includes a clarifying sentence confirming that the Federal definition of the term interest does not change a state's definition of interest (nor how the state definition of interest is used) solely for purposes of state law. Paragraph (c) of Sec. 7.4001 also provides the example described in the immediately preceding paragraph of this preamble to illustrate this concept. The final ruling is substantially identical to the proposal, with the addition discussed above. In addition, the reference to "Morris Plan banks" that appeared in the last sentence of proposed Sec. 7.4001(b) has been removed as obsolete. Finally, paragraph (c), "Usury," in the proposal has been redesignated as paragraph (d) in the final ruling.

Most courts interpreting 12 U.S.C. 85 have concluded that various forms of non-percentage-based charges (including such items as late payment, overlimit, and annual fees) for the use of borrowed money fall within the scope of 12 U.S.C. 85. The final ruling is consistent with OCC interpretive letters in this area (see, e.g., OCC Interpretive Letter No. 670 (Feb. 17, 1995), reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH)

para. 83,618, and the letters cited therein) and reflects the position the OCC has taken in amicus curiae briefs in litigation pending in many state and Federal courts (see, e.g., OCC brief filed in the Supreme Court of Pennsylvania in Bank One, Columbus, N.A. v. Mazaika, Nos. 1995-31 and 1995-33 (July 17, 1995) (urging reversal of Mazaika v. Bank One, Columbus, N.A., 653 A.2d 648 (Pa. Super. Ct. 1994) (en banc), appeal granted, 659 A.2d 557 (Pa. 1995)).

Recently, the California Supreme Court upheld the ability of a national bank to charge certain fees as a component of "interest" and cited the OCC's recent interpretive opinions, as well as proposed Sec. 7.4001, as consistent with the court's reasoning. Smiley v. Citibank (South Dakota), N.A., 900 P.2d 690 (Cal. 1995), cert. granted, 64 U.S.L.W. 3500 (U.S. Jan. 19, 1996) (No. 95-860) (holding that the term "interest" as used in 12 U.S.C. 85 encompasses late payment fees, if such fees are allowed by a national bank's home state). See also Copeland v. MBNA America Bank, N.A., 907 P.2d 87 (Colo. 1995) (en banc), pet. for cert. filed, 64 U.S.L.W. 3469 (U.S. Dec. 28, 1995) (No. 95-1056); Richardson v. Citibank (South Dakota), N.A., No. 94SC670, 1995 Colo. LEXIS 767 (Colo. Dec. 18, 1995) (en banc); Spellman v. Meridian Bank (Delaware), Nos. 94-3203-3204, 94-3215-3218, 1995 U.S. App. LEXIS 37149 (3d Cir. Dec. 29, 1995).

However, the Supreme Court of New Jersey also issued a recent decision concluding that "interest" as used in 12 U.S.C. 85 does not include late payment fees. Sherman v. Citibank (South Dakota), N.A., No. A-102-94, 1005 WL 710414 (N.J. Nov. 28, 1995), pet. for cert. filed, 64

U.S.L.W. 3439 (U.S. Dec. 21, 1995) (No. 95-991). The decision of the New Jersey Supreme Court in Sherman conflicts with the decisions of the California Supreme Court in Smiley, the Colorado Supreme Court in Copeland and Richardson, and the U.S. Court of Appeals for the Third Circuit in Spellman, and the earlier decision of the First Circuit in Greenwood Trust. The U.S. Supreme Court recently granted certiorari in Smiley to resolve the conflict on an expedited basis.

As noted in the proposal, the ruling is not intended to be a comprehensive treatment of the issue, and other fees or charges may also be found to be components of interest.

REPLY APPENDIX B

[Other Letter Headings Omitted In Printing]

UNITED STATES SENATE

COMMITTEE ON SMALL BUSINESS

WASHINGTON, DC 20510-6350
April 25, 1995

The Honorable Eugene Ludwig
Comptroller of the Currency
250 "E" Street, S.W.
Washington, D.C. 20219

Dear Mr. Ludwig:

We want to pass on to you the concerns of community bankers in Arkansas as well as our own thoughts regarding the proposed revisions of the OCC's interpretive rulings concerning calculation of interest rates.

According to news release NR 95-26, dated March 2, 1995, the Office of the Comptroller of the Currency intends to codify current OCC letters and individual case authority on types of charges included or not included in the term "interest" as used by law. While we understand the intention of the OCC's interpretation of Part 7 of 12 U.S.C. 85, the actual regulatory application may override a provision in the Arkansas State Constitution concerning usury.

The definition of "interest" has been litigated in the Arkansas courts for many years because of the state's strong policy against excessive interest rates. For 110 years the Arkansas Constitution prohibited lenders from charging any borrower more than ten percent (10%) interest. The penalty for violation of this rule was forfeiture of all principal and interest. The Constitution of 1874 was

amended in 1984 to provide a more modern approach by limiting the maximum rate of interest which can be charged by both state and national banks to the lesser of (i) five percent (5%) over the federal discount rate that is in effect at the time of the loan, or (ii) seventeen percent (17%).

Violation of this constitutional interest limitation also has severe repercussions, including repayment to the borrower of twice the amount of interest paid and forfeiture of future interest. In addition, violating the constitutional maximum places responsibility on the lender for the borrower's attorneys' fees.

Arkansas banks are extremely worried that loans now perfectly acceptable under Arkansas state usury laws could be found in a usurious position because of the OCC's definition of "interest". We ask that you carefully consider the legal ramifications for Arkansas bankers before issuing a federal regulation that overrides Arkansas state law.

Several bankers have written to us and to your office explaining these worries. Enclosed are a few copies for your information.

Thank you for your timely consideration of this matter.

Sincerely,

/s/ David
David Pryor

/s/ Dale
Dale Bumpers

[LOGO]
ARKANSAS COMMUNITY BANKERS

[Other Letter Headings Omitted In Printing]

April 3, 1995

Comptroller of the Currency
Administrator of National Banks
250 E Street, S.W.
Washington, D.C. 20219

Re: News Release 95-26

Dear Ms. Salus:

Arkansas Community Bankers Association represents 195 independent community banks in the State of Arkansas. The recently published News Release 95-26 regarding OCC proposals raises serious concern among bankers in Arkansas.

The Constitution of the State of Arkansas limits the maximum rate of interest which can be charged by both state and national banks to the lesser of: (i) five percent (5%) over the federal discount rate in effect at the time of the loan, or (ii) seventeen percent (17%). Violation of this constitutional interest limitation has severe repercussions, including repayment to the borrower of twice the amount of interest paid, and forfeiture of future interest. Additionally, violation of the constitutional maximum places responsibility on the lender for the borrower's attorneys' fees. Thus, all Arkansas banks, both state and federally chartered, diligently comply with the Constitutional provision.

The Comptroller of the Currency (OCC) has issued proposed revisions to its interpretive rulings (part 7 of its

regulations). Within the proposed provision, the OCC attempts to incorporate its private letter rulings and case authority from jurisdictions outside Arkansas concerning the types of charges which are or are not included as "interest". This proposed revision apparently attempts to utilize for national banks, to the maximum extent possible, the provisions of 12 U.S.C. § 85.

The implication of a regulatory definition of "interest," inclusive of charges which do not presently constitute "interest" under existing Arkansas law, is potentially damaging to all state and federally chartered banks in Arkansas.

The undersigned requests in OCC to reconsider its proposed revision to part 7 of its regulations, to provide that the proposed revisions apply only when a national bank is attempting to export its home state usury laws for loans to out-of-state borrowers, i.e., limit the proposed revision to part 7 as an interpretation by the OCC of 12 U.S.C. § 85. In the alternative, the OCC could make the proposed provisions optional, at the election of each institution.

The undersigned vigorously urges the OCC to consider the implications of a regulatory definition of "interest" upon banks located in states with constitutional interest limitations, such as Arkansas. Otherwise, Arkansas banks will face the dilemma of "dual accounting" systems wherein one calculation of "interest" is done pursuant to OCC regulation, with a second calculation maintained for protection under the Arkansas usury law. If the proposed OCC definition of "interest" is adopted, any calculation of interest made thereunder will be discoverable and

admissible in court to convince a trier of fact that a loan, presently acceptable under Arkansas usury law, is usurious because of the regulatory definition of "interest."

Thank you for your consideration in this matter. Please call me with any questions.

Sincerely,

/s/ Pete Maris
Pete Maris
President
Arkansas Community Bankers
Chairman
Bank of Little Rock

PM/rt

cc: Arkansas Washington Delegation

Supreme Court, U.S.
FILED
MAR 29 1996
CLERK

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No. 95-860

In the Supreme Court of the United States

OCTOBER TERM, 1995

BARBARA SMILEY, PETITIONER

v.

CITIBANK (SOUTH DAKOTA), N.A.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF CALIFORNIA

BRIEF FOR THE UNITED STATES AND THE COMPTROLLER OF THE CURRENCY AS AMICI CURIAE SUPPORTING RESPONDENT

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43 pp

QUESTION PRESENTED

Whether credit card late fees are "interest" within the meaning of 12 U.S.C. 85, which permits a national bank to charge "interest" on its loans "at the rate allowed" by the State in which the bank is located.

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BARBARA SMILEY, PETITIONER

v.

CITIBANK (SOUTH DAKOTA), N.A.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF CALIFORNIA

BRIEF FOR THE UNITED STATES AND THE COMPTROLLER OF THE CURRENCY AS AMICI CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES AND THE COMPTROLLER OF THE CURRENCY

The Comptroller of the Currency is the primary regulator of national banks chartered under the National Bank Act, 12 U.S.C. 21 *et seq.* See *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995). The resolution of the question presented in this case will affect that responsibility. The Comptroller has issued a regulation that interprets the term "interest" in 12 U.S.C. 85 to include late fees. 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a)). The Comptroller participated as an amicus curiae

before the California Supreme Court in this case, and before the New Jersey Supreme Court in *Sherman* v. *Citibank (South Dakota), N.A.*, 668 A.2d 1036 (1995), petition for cert. pending, No. 95-991, which raised the same issue.

STATEMENT

1. Respondent Citibank (South Dakota), N.A. (Citibank) is a national bank located in Sioux Falls, South Dakota. Pet. App. 2. Citibank issues credit cards under the "Visa" and "Mastercard" service marks. *Ibid.* Petitioner Barbara Smiley, who lives in Los Angeles County, California, holds two Citibank credit cards. *Ibid.* The agreements for the use of those cards both provide for finance charges on the unpaid balance and late fees for failure to make the minimum required payment on time.

The agreement for one of petitioner's cards (the Classic Card) provides that, if petitioner does not pay the outstanding balance in full before its due date, Citibank will impose a finance charge of 1.65% on the average daily balance for that monthly billing period. J.A. 51-52. A minimum monthly payment is required for outstanding balances. J.A. 55. For each monthly billing period in which petitioner fails to make her minimum monthly payment within 25 days of its due date, Citibank imposes a late fee of $15 in addition to the monthly finance charge. J.A. 56. The agreement for petitioner's other card (the Preferred Card) provides that, if petitioner does not pay the outstanding balance in full before its due date, Citibank will impose a monthly finance charge of 1.4% on the average daily balance. J.A. 67-68. If petitioner does not make the minimum monthly payment within 15 days of its due date, Citibank will impose a late fee of

$6 in addition to the monthly finance charge. J.A. 74. If that minimum payment is not received by the next minimum monthly payment due date, Citibank imposes an additional late fee of $15 or .65% of the outstanding balance, whichever is greater. *Ibid.* The finance charges and late fees imposed by Citibank are permitted by South Dakota law. S.D. Codified Laws Ann. §§ 54-3-1, 54-3-1.1 (1990 & Supp. 1995).

2. In 1992, petitioner filed a class action complaint against Citibank in California superior court on behalf of herself and other California holders of Citibank credit cards. Pet. App. 2. She alleged that Citibank had violated California consumer protection laws by charging its California credit card customers a late fee of up to $15. *Ibid.* Citibank moved for judgment on the pleadings, arguing that petitioner's claims are preempted by 12 U.S.C. 85, which permits a national bank to charge "interest at the rate allowed by the laws of the State * * * where the bank is located." Pet. App. 3-4.

The superior court initially denied Citibank's motion. Pet. App. 4. After the California court of appeal issued a writ of mandate directing the superior court to either grant Citibank's motion or show cause why it should not be required to do so, however, the superior court granted Citibank's motion. *Id.* at 5. The court of appeal affirmed. *Ibid.*

3. After granting review, the Supreme Court of California affirmed. Pet. App. 1-72. The court held that "interest" under Section 85 includes "a late payment fee, payable contingently in the event of default after maturity." *Id.* at 19. The court reasoned that, at the time of the enactment of Section 85, the term "interest" included any charge for the use or

detention of money, *id.* at 18, and that definition "easily encompasses late payment fees," *id.* at 21.

The court also concluded that excluding late fees from the definition of "interest" would undermine Congress's decision to grant national banks "most favored lender" status in the States in which they are located so as to protect them from unfriendly state legislation. Pet. App. 21-22. For example, "a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks*, but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks*, at a level high enough that *they* could lend at a profit." *Id.* at 22.

The court further concluded that excluding late fees from Section 85 would adversely affect the national banking system. Subjecting national banks to the varying laws of the States on late fees could "throw into confusion the complex system of modern interstate banking" and "undermine the conditions for uniformity and efficiency that would otherwise obtain." Pet. App. 29. Precluding a national bank from charging the credit terms allowed by the State in which it is located would also have "a corresponding adverse effect on the national bank's potential customer, whose freedom to borrow on conditions he deems reasonable would also be restricted." *Ibid.* (emphasis omitted). The court noted that its interpretation was "in line with interpretations of the Comptroller of the Currency, who 'is charged with the enforcement of the [federal] banking laws.'" *Id.* at 27 (quoting *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995)).

Judge Arabian and Judge George dissented. Pet. App. 42-62, 63-72. Judge Arabian concluded that, by linking the terms "interest" and "rate," Section 85 limits "interest" to a sum calculated as a percentage of the loan over time. *Id.* at 45-46. Judge George concluded that fees that depend on the borrower's own conduct during the term of the loan, such as late payment fees, are not "interest" within the meaning of Section 85. *Id.* at 65-66.

SUMMARY OF ARGUMENT

The question presented in this case is whether credit card late fees are "interest" within the meaning of 12 U.S.C. 85, which permits a national bank to charge interest on its loans at the rate allowed by the State in which the bank is located. The Comptroller of the Currency has reasonably concluded that late fees are interest. The Court should defer to that conclusion.

A. The Comptroller's view that late fees are interest is consistent with the meaning of that term at the time Congress enacted Section 85 in 1864. At that time, interest was defined broadly as any charge for the use or detention of money. Consistent with that understanding, state courts of that era characterized charges for late payment as interest. That was true regardless of whether the late charges were in the form of flat fees or an increase in the percentage interest rate for the loan.

The use of the term "rate" in Section 85 does not limit the late payment fees covered by that provision to those expressed as a percentage of the outstanding balance. When Congress enacted Section 85, the rate of interest meant the amount of interest, and therefore encompassed flat late fees as well as percentage

charges. Flat fees can also readily be converted to percentage charges to determine whether they exceed any applicable percentage limits. They are no less interest when a State puts no percentage limitation on late fees.

The resolution of the question in this case does not depend on whether Citibank's late fee is viewed as a penalty. When a charge is for the use or detention of money, it is interest, regardless of whether it is also aptly characterized as a penalty. Petitioner's contention based on its characterization of Citibank's late fee as a penalty is a claim that the amount of the fee is excessive when compared to the increased risks and costs associated with late payment. Congress has committed that question to the State in which a national bank is located.

B. The Comptroller's conclusion that late fees are interest is also consistent with the purposes of Section 85. Congress enacted Section 85 in order to give national banks most-favored-lender status so that they could establish a firm footing in potentially hostile States. If late fees were not treated as interest, States could give certain preferred state lenders the exclusive right to charge late fees, depriving national banks of their most-favored-lender status and putting them at a significant competitive disadvantage in the marketing of credit cards. Congress also enacted Section 85 with the goal of establishing a national banking system. If national banks were required to shape their late fee charges to meet the varying and changing requirements in the 50 States, it would introduce additional burdens and unnecessary confusion into the already complex system of modern interstate banking.

C. The Comptroller's interpretation is entitled to deference. Congress has delegated to the Comptroller the authority to enforce the National Bank Act and to issue regulations to carry out that responsibility. This Court has therefore held that the Comptroller is entitled to deference when he interprets the requirements of that Act. Petitioner's contention that deference is not warranted because the Comptroller has interpreted Section 85 inconsistently is incorrect. The prior interpretive letters identified by petitioner do not detract from the significance of the Comptroller's current position.

D. Because late fees are interest within the meaning of Section 85, state laws that purport to preclude a national bank from imposing late fees that are allowed by the State in which the bank is located are preempted. Petitioner's view that such state laws are not preempted because it cannot be proved to a certainty that late fees are interest is incorrect. The question whether Section 85 interest includes late fees is governed by ordinary principles of statutory construction and administrative deference. Those principles lead to the conclusion that late fees are interest.

ARGUMENT

THE COMPTROLLER OF THE CURRENCY HAS REASONABLY CONCLUDED THAT CREDIT CARD LATE FEES ARE INTEREST WITHIN THE MEANING OF 12 U.S.C. 85

Section 85, originally enacted as Section 30 of the National Bank Act, ch. 106, 13 Stat. 108 (1864), provides that national banks may "take, receive, reserve, and charge on any loan or discount made * * * interest at the rate allowed by the laws of the State * * * where the bank is located." 12 U.S.C. 85. In *Tiffany* v. *National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 413 (1873), the Court held that Section 85 permits national banks to charge the highest interest rate allowed to lenders in the States in which they are located, even if that rate is not available to state banks. The Court concluded that Congress gave national banks that special protection because there was a very real danger that States would seek to undermine the national banks through "unfriendly legislation." *Ibid.* The Court added that, because national banks were established for the purpose of providing a currency for the whole country and to create a market for the loans of the federal government, Congress had always treated national banks as "National favorites." *Ibid.* The Court has since characterized the protection for national banks recognized in *Tiffany* as "'most favored lender' status." *Marquette Nat'l Bank* v. *First of Omaha Serv. Corp.*, 439 U.S. 299, 314 n.26 (1978).[1]

[1] Even absent Section 85, state laws that discriminate against national banks or impose an undue burden on their functions would be preempted. *Anderson Nat'l Bank* v.

In *Marquette*, the Court held that Section 85 permits a national bank to charge its out-of-state customers the rate of interest allowed by the State in which the national bank is located. 439 U.S. at 314-319. The Court therefore concluded that a national bank located in Nebraska could charge its Minnesota customers the annual interest rate on their unpaid credit card balances permitted by Nebraska law, even though Minnesota imposed a lower limit. *Id.* at 302. The Court stated that the Congress that enacted Section 85 "fully recognized the interstate nature of American banking" and intended to facilitate a "national banking system" by permitting national banks to offer the interest rate permitted by the State in which it was located to all of its customers. *Id.* at 314-318. The Court rejected the contention that Congress could not have intended to impair a State's traditional power to enact effective usury laws for the protection of its citizens, reasoning that such impairment "has always been implicit in the structure of the National Bank Act, since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates." *Id.* at 318. Although the ease with which credit cards may be obtained through the mail "accentuated" the impairment of state usury laws, that difference did not call for a different result. *Id.* at 318-319.

The question in this case is whether credit card late fees, like the percentage charges on unpaid outstanding balances at issue in *Marquette*, are "interest" within the meaning of Section 85. If late fees are interest under Section 85, a national bank

Luckett, 321 U.S. 233, 248 (1944); *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 436-437 (1819).

may charge its out-of-state cardholders such fees at the rate permitted by the law of the State in which the bank is located, without regard to any limitations imposed by other States. If late fees are not interest under Section 85, limitations on late fees imposed by the States in which credit card customers reside would not be preempted by Section 85.

Resolution of the question presented in this case should begin with the recognition that the Comptroller of the Currency has concluded that late fees are interest within the meaning of Section 85. The Comptroller reached that conclusion at least as early as 1955. At that time, Pennsylvania law permitted lenders to collect a delinquency charge on an installment loan of 6% of the overdue installment or $15, whichever was smaller. In response to an inquiry concerning whether national banks located in Pennsylvania could impose delinquency charges on installment loans, the Deputy Comptroller replied that Section 85 gave national banks the right to impose the delinquency charges authorized by Pennsylvania law. Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) (*reprinted at* App., *infra*, 7a-8a). Since 1955, the Comptroller has issued interpretive letters reaffirming the position that Section 85 permits national banks to charge late fees to the extent that such fees are allowed by the State in which the bank is located. Letter from Julie L. Williams, Chief Counsel, to John L. Douglas, Esq. (Feb. 17, 1995), [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,696-86,697; Letter from William P. Bowden, Jr., Chief Counsel, to Robert G. Ballen, Esq. 6 (Feb. 4, 1992); Letter from Robert B. Serino, Deputy Chief Counsel (Policy) (Aug. 11, 1988), [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,066 & n.3 (OCC Interpretive Letter No. 452).

On February 9, 1996, the Comptroller published an interpretive regulation incorporating the view that late fees are interest. That regulation states that the term "interest" under Section 85 "includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a)). Included in that definition are "numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees." *Ibid.*[2]

In *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995), the Court held that the Comptroller's interpretations of the National Bank Act are entitled to *Chevron* deference. See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S 837, 842 (1984). Accordingly, when a provision of the National Bank Act "is silent or ambiguous" on an issue, the Court defers to the Comptroller's interpretation, so long as it reflects "a permissible construction." *NationsBank*, 115 S. Ct. at 813 (quoting *Chevron*, 467 U.S. at 843). Stated differently, when

[2] The regulation also states that interest under Section 85 "does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports." 61 Fed. Reg. 4869 (daily ed. Feb. 9, 1996).

the Comptroller's interpretation of the National Bank Act "fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design," the Court gives the Comptroller's judgment "controlling weight." 115 S. Ct. at 813-814 (quoting *Chevron*, 467 U.S. at 844). For reasons that follow, the Comptroller has reasonably concluded that late fees are interest within the meaning of Section 85. The Court should therefore give the Comptroller's interpretation controlling weight.

A. The Comptroller's Conclusion That Late Fees Are Interest Is Consistent With The Meaning Of Interest At The Time Congress Enacted Section 85

1. At the time Section 85 was enacted in 1864, the term "interest" meant any charge by a lender for the use or detention of money. Thus, in a case decided shortly after the enactment of Section 85, the Court defined interest as "the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown* v. *Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873). Subsequent cases adopted a similarly broad definition of interest. See *Redfield* v. *Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) ("Interest is given on money demands as damages for delay in payment, being just compensation to the plaintiff for a default on the part of his debtor."); *United States* v. *North Carolina*, 136 U.S. 211, 216 (1890) ("Interest * * * is allowed by the courts as damages for the detention of money * * * or of compensation[] to which the [lender] is entitled."); *Shoemaker* v. *United States*, 147 U.S. 282, 321 (1893) ("Interest * * * [includes] damages, by reason of the failure of the debtor to pay the principal when due.").

Consistent with that understanding of the meaning of interest, nineteenth century case law characterized charges for late payment as interest. That view prevailed regardless of whether the late fees were in the form of flat fees or an increased percentage rate after default. See, *e.g.*, *Daggett* v. *Pratt*, 15 Mass. 177 (1818) (notes providing for 3% interest if paid at maturity, "if not, six per cent. interest to be paid"); *Wernwag* v. *Mothershead*, 3 Blackf. 401, 402 (Ind. 1834) (promissory note providing that, if it was not paid when due, the borrower would pay "five dollars interest per week" until the note was paid off); *Wilkinson* v. *Daniels*, 1 Greene 179, 188 (Iowa 1848) (note providing for 12% interest if paid at maturity, "and if not paid to the day, fifteen per cent"); *Craig* v. *Pleiss*, 26 Pa. 271, 273 (1856) (concluding that $25 flat late fee was a "rate of compensation" within a state usury statute). The Comptroller's conclusion that the term "interest" includes late fees is therefore consistent with the meaning that term had at the time Congress enacted Section 85.

2. Petitioner contends (Br. 11, 15-16) that the coupling of the term "rate" with the term "interest" in Section 85 narrows the late fees covered by that provision to those that are charged as a percentage of the outstanding balance. See 12 U.S.C. 85 (permitting a national bank to collect interest "at the rate" allowed by the State in which it is located). Under that interpretation, Citibank's late charge of .65% of the outstanding balance on its Preferred Card would be interest, J.A. 74, while the flat charge of $15 on its Classic Card would not be, J.A. 56. At the time of the enactment of Section 85, however, the "rate" of interest meant the amount of interest; it was not limited in meaning to a percentage charge. See 2

Noah Webster, *American Dictionary of the English Language* (1828) (def. 2; "rate" means: "Price or amount stated or fixed on any thing. * * * The *rate* of interest is prescribed by law."); *Craig*, 26 Pa. at 273 (describing a $25 flat late fee as a "rate of compensation"); *Wernwag*, 3 Blackf. at 402 (describing a flat late fee of $5 per week as "interest at the rate specified in the note"). The phrase interest "at the rate allowed" by the State therefore encompasses late fees that are expressed in both flat and percentage terms.

The incorrectness of petitioner's view that a flat late fee is not interest under Section 85 becomes clear when a bank charges a flat fee in a State that places a percentage limit on late fees. For example, suppose a State set a limit on late fees of 10% of the outstanding balance. A national bank that charged a $15 flat late fee on outstanding balances of $50 clearly could not defend a suit alleging that it had exceeded the lawful rate of interest permitted by Section 85 by claiming that it was charging something other than interest. In that situation, a court would be required to convert the flat fee to a percentage of each customer's balance in order to determine whether the Bank had charged a permissible rate of interest. The Court would conclude that the $15 fee could be charged to persons with balances of $150 or more, but not to persons with balances of less than $150 (10% of $150 = $15). If flat late fees are interest within the meaning of Section 85 when a State sets a percentage limit on such fees, they are equally interest under Section 85 when a State like South Dakota sets no limit (percentage or otherwise) on late fees. See *Daggs* v. *Phoenix Nat'l Bank*, 177 U.S. 549, 554-555 (1900) (Section 85 adopts state law rate of interest even when the applicable state law permits the parties to agree by contract to any rate of interest).[3]

3. Petitioner also contends (Br. 32) that Citibank's late fees are not interest because they are not time-based. In fact, however, Citibank's late fees are time-based. Under Citibank's Classic Card agreement, for example, Citibank charges a $15 late fee for every month in which the minimum payment is not made on time. J.A. 56. If a cardholder continually fails to make the minimum payment, late fees will accrue at the rate of $15 per month.

4. Petitioner argues (Br. 35-40) that there is a sharp distinction between interest and a penalty, and that Citibank's flat late fee is a penalty rather than interest. When a charge is made for the use or detention of money, however, it does not lose its character as interest within the meaning of Section 85 simply because the charge may also aptly be characterized as a penalty. Indeed, "[t]he institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan." See *Library of Congress* v. *Shaw*, 478 U.S. 310, 315 n.2 (1986).

This Court's decision in *Citizens' Nat'l Bank* v. *Donnell*, 195 U.S. 369 (1904), illustrates that the description of a lending charge as a "penalty" does not remove it from the category of interest covered by Section 85. In that case, a national bank had assessed

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[3] If the rate allowed by the State needed to be expressed in percentage terms before a flat late fee would be treated as interest, it would mean that South Dakota would have the power to change the outcome in this case by setting an extremely high percentage limit on late fees, such as 500% of the outstanding balance. The scope of Section 85 does not depend on such meaningless distinctions.

an overdraft charge of 12%, which exceeded the permissible rate of interest in the State in which the bank was located. The bank argued that the overdraft charge did not violate Section 85 because it was a penalty for late payment. *Id.* at 373-374. The Court rejected that argument and held that the overdraft charge violated Section 85. *Ibid.*

Petitioner's characterization of Citibank's late fee as a penalty is also incomplete. The Comptroller has concluded that "[c]redit risks associated with delinquent borrowers are typically higher than for comparable borrowers who have not been delinquent, and a bank's costs for monitoring and collecting an account rise if the account is late." Williams Letter, *supra*, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,696. The Comptroller has further concluded that "[c]redit card late fees are increased charges to borrowers who engage in delinquent payment behavior in order to compensate the bank for these increased lending costs and risks, just as banks customarily charge higher rates in other contexts to borrowers who have had payment problems or otherwise appear to pose higher risks." *Ibid.*; see also *Meilink* v. *Unemployment Reserves Comm'n*, 314 U.S. 564, 567 (1942) (approving the recovery of interest under the Bankruptcy Act exceeding the normal rate to compensate for increased risk and administrative costs associated with delinquent taxpayers).

Petitioner does not deny that late payers impose such increased risks and costs. Nor does petitioner claim that a bank is precluded from seeking to cover those increased risks and costs by imposing higher interest charges on late payers. Instead, petitioner contends (Br. 33, 39) that Citibank's late fee greatly

exceeds any additional risk or cost to the bank that flows from a cardholder's failure to make the minimum payment on time. But that argument is simply a claim that Citibank's late fees are excessive. Congress has committed the question whether an interest charge is excessive to the State in which the national bank is located. Just as Section 85 permits the State in which a bank is located to decide how much a bank should be permitted to profit from its percentage rate finance charges on unpaid balances, so Section 85 permits the State in which a national bank is located to decide whether and how much the bank should be permitted to profit from its late fee charges.[4]

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[4] Petitioner contends (Br. 30, 33, 35) that several decisions of this Court establish that Section 85 draws a distinction between interest and penalties. The cases on which petitioner relies do not support that conclusion. In *Lloyd* v. *Scott*, 29 U.S. (4 Pet.) 205, 226 (1830), the Court stated that contingent late fees that exceed the lawful usury limit are not regarded as usurious because the borrower may avoid the charge by paying on time. In *Spain* v. *Hamilton's Adm'r*, 68 U.S. (1 Wall.) 604, 626 (1864), the Court held that certain contingent charges would not be counted against a usury limit because they were not designed to evade that limit. *Lloyd* and *Spain* therefore addressed whether contingent charges were subject to the state usury laws, not whether those charges were interest. In *Meilink*, 314 U.S. at 570, the Court drew a distinction between interest and penalties for purposes of deciding what charges could be recovered under the Bankruptcy Act. But that is because the text of the Bankruptcy Act drew that distinction. *Id.* at 566. And in *United States* v. *Texas*, 507 U.S. 529, 536 (1993), the Court noted only that the common law right to prejudgment interest did not include the right to collect penalties. See also *Deputy* v. *du Pont*, 308 U.S. 488, 498 n.11 (1940) (noting that interest means different things in different contexts); cf. *NationsBank*, 115 S. Ct. at 814 (holding that the

B. The Comptroller's Interpretation Furthers The Purposes of Section 85

1. The Comptroller's view that late fees are interest also advances the purposes of Section 85. As previously discussed, in enacting Section 85, Congress intended to protect national banks against "unfriendly State legislation" by according them most-favored-lender status in the State in which they are located. *Tiffany*, 85 U.S. (18 Wall.) at 412. Congress wanted to ensure that national banks would have a "firm footing" in the States in which they were located so that they could compete effectively with other lenders in the State. *Ibid.* If late fees are not interest, a State could give a preferred category of state lenders the exclusive right to charge late fees, effectively divesting national banks of their most-favored-lender status and putting them at a significant competitive disadvantage. Permitting a State to institute that sort of preference would create the vary harms that Congress sought to avoid when it enacted Section 85.

The dangers that Congress anticipated in 1864 have not disappeared. For example, for a time, New Jersey permitted only credit unions to charge credit card late fees, giving credit unions a distinct advantage over national banks in marketing such cards. See N.J. Stat. Ann. § 17:13-104(b) (West Supp. 1995). The Comptroller's interpretation of Section 85 does not countenance such "unfriendly" state legislation.

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characterization of annuities in other settings as insurance did not preclude the Comptroller from concluding that annuities are not insurance for the purposes of the National Bank Act).

2. The Comptroller's interpretation also accords with the reality that a bank's periodic finance charge and its late fees are part of a package of lending charges. The periodic percentage rate compensates the bank for the time value of money, and the late fee compensates the bank for the increased risks and costs associated with late payment. The two are functionally interrelated. If state law prevents a national bank from imposing a late fee, or limits the amount of such a fee, the bank might then increase the percentage charge on the overall balance due to compensate for the added costs associated with late payers. Different views may be taken on which is a fairer way for banks to recover the additional costs. But the Comptroller could reasonably decide that a bank's recovery of such costs is interest, regardless of which approach a bank takes. Cf. *NationsBank*, 115 S. Ct. at 814-815, 817 (concluding that the functional similarity between annuities and investments that banks typically sell supported the Comptroller's conclusion that the brokerage of annuities is incidental to the business of banking).

3. The Comptroller's conclusion that late fees are interest is also consistent with the Court's recognition in *Marquette* that the National Bank Act was intended to establish and promote a "*national* banking system," *Marquette*, 439 U.S. at 315 (emphasis added). As the Court noted in *Marquette*, that purpose is facilitated when national banks can offer the lending charges permitted by the State in which they are located to all of their customers. *Id.* at 314-318. If national banks must shape their late fee charges to meet the varying and changing requirements of the 50 States in which they market their cards, it would introduce additional burdens and

unnecessary confusion into the already "complex system of modern interstate banking." *Id.* at 312.

4. Treating late fees as interest that may be charged at the rate allowed by the State in which the bank is located also has advantages for consumers. In particular, it increases the ability of consumers to choose the credit card with the finance terms that best suits their needs. States may take varying approaches to the kind of charges they will permit lenders within their jurisdiction to impose, and banks may take varying approaches to the kinds of credit arrangements they wish to offer within the limits set by the States in which they are located. Some States may permit high percentage finance charges but no late fees; others may set a low percentage limit on finance charges, but permit late fees; and still others may not set any limits on either the percentage finance charge or late fees. Under the interpretation adopted by the Comptroller, consumers in every State will have the ability to select from among a potentially wide variety of options, rather than being restricted to the combination of charges permitted in the consumer's own State.

C. The Comptroller's Interpretation Is Entitled To Deference

1. Petitioner contends (Br. 27-28) that the Comptroller's interpretation is not entitled to deference because Congress has not delegated authority to the Comptroller to enforce or interpret Section 85. But Congress has given the Comptroller broad power to enforce the requirements of the National Bank Act through administrative proceedings, and that includes the authority to enforce Section 85. 12 U.S.C. 93 (power to impose civil penalties on national banks

for violations of the National Bank Act); 12 U.S.C. 1818(b) (power to issue cease-and-desist orders against national banks to prevent violations of any law, rule, or regulation). Congress has also given the Comptroller authority "to prescribe rules and regulations to carry out the responsibilities of the office." 12 U.S.C. 93a. Petitioner's contention that Congress has not given the Comptroller the authority to enforce or interpret Section 85 is therefore incorrect. See also *NationsBank*, 115 S. Ct. at 813 ("As the administrator charged with supervision of the National Bank Act, the Comptroller bears primary responsibility for surveillance of 'the business of banking'") (citations omitted); *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-627 (1971) ("The Comptroller of the Currency is charged with the enforcement of the banking laws").

As petitioner notes, 12 U.S.C. 86 authorizes a private right of action to recover penalties for violations of Section 85. *Adams Fruit Co.* v. *Barrett*, 494 U.S. 638, 649-650 (1990), holds that an administrative agency does not ordinarily have the authority to interpret enforcement provisions that are reserved for private parties. But this case involves an interpretation of the meaning of Section 85, which may be enforced administratively as well as judicially. It does not involve the interpretation of the scope of the penalties available under Section 86. Petitioner's reliance on *Adams Fruit* is therefore misplaced.

2. Petitioner also contends (Br. 28-29) that the Comptroller's current interpretation of Section 85 is not entitled to deference because it is inconsistent with previous interpretations offered by the Comptroller. An inconsistency in an agency's position, however, does not eliminate the deference that is

owed to the agency's current position. *NationsBank*, 115 S. Ct. at 817. The ultimate inquiry is whether the agency's current position is reasonable. *Id.* at 813. If it is, any inconsistency with prior positions is beside the point.

The interpretive letters relied on by petitioner as evidence of inconsistency do not detract from the force of the Comptroller's current position. In arguing that the Comptroller has previously stated that late fees are not interest under Section 85, petitioner relies on a brief letter issued by then-Comptroller Saxon in 1964. The portion of the letter relied on by petitioner states that "[c]harges for late payments, credit life insurance, recording fees, [and] documentary stamp[s] are illustrations of charges which are made by some banks which would not properly be characterized as interest." App., *infra*, 9a-10a. That letter, however, does not mention Section 85. And from the context of the letter, it appears that then-Comptroller Saxon was not addressing the meaning of interest under Section 85, but was instead addressing what charges would be counted as interest in determining whether a bank had exceeded a State's periodic percentage limit. See *ibid.* (responding to additional questions concerning the periodic percentage rate of certain States and the formula that is used to convert charges to a rate equivalent).

Petitioner argues further (Br. 28-29) that the rationale for the Comptroller's interpretation has changed over time. As petitioner notes, an interpretive letter issued by then-Deputy Chief Counsel Serino in 1988 suggested that a national bank could collect late fees under Section 85, because the State in which the bank was located had defined interest to

include late fees. Serino Letter, *supra*, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,066 & n.3. The Comptroller has since clarified his view that the meaning of the term "interest" under Section 85 is a question of federal law, and that the way a State defines interest for its own purposes is not controlling. Williams Letter, *supra*, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,467, at 86,693-86,694 & n.3. That approach is also embodied in the Comptroller's current regulation. See 61 Fed. Reg. 4858, 4869 (daily ed. Feb. 9, 1996) (to be codified at 12 C.F.R. 7.4001(a) (promulgating federal definition of interest under Section 85)). Petitioner agrees with the Comptroller's current view that what constitutes interest is a question of federal law. The inconsistency in approach identified by petitioner therefore does not have any bearing on the reasonableness of the Comptroller's current position.[5]

D. State Laws That Purport To Limit The Late Fees That A National Bank Located Elsewhere May Collect Are Preempted

1. A state law is preempted by federal law not only when the state law and the federal law are in "irreconcilable conflict," *Barnett Bank of Marion County, N.A.* v. *Nelson*, No. 94-1837 (Mar. 26, 1996), slip op. 5 (quoting *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)), but also when the state law "stands as an obstacle to the accomplishment and

[5] Because the Comptroller's conclusion that late fees are interest is based on a federal definition of interest, and the California Supreme Court's decision is premised on that same view, the first two questions raised in the petition are not presented in this case.

execution of the full purposes and objectives of Congress," *Barnett Bank*, slip op. 5 (quoting *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941)). In this case, Section 85 authorizes a national bank to charge interest at the rate allowed by the State in which the bank is located. Any state law that attempts to limit the interest that Section 85 authorizes national banks to charge "stands as an obstacle" to the achievement of Congress's purposes and is therefore preempted. The Court reached precisely that conclusion in *Marquette*, when it noted that state efforts to limit the amount of interest that Section 85 authorizes a national bank to charge "must, of course, give way to the federal statute." 439 U.S. at 318 n.31; see also *Barnett Bank*, slip op. 5 (when the National Bank Act authorizes a national bank to engage in a particular activity, a State's prohibition of that activity stands as an obstacle to the accomplishment of Congress's purposes and is therefore preempted).

The preemption question presented in this case is no different from the one presented in *Marquette*. Because late fees fall within the category of interest covered by Section 85, state laws that purport to preclude a national bank from imposing late fees that are authorized by the State in which a national bank is located are preempted.

2. Petitioner nonetheless contends (Br. 18) that state laws governing credit card late fees that purport to apply to national banks located elsewhere are not preempted because it cannot be shown "to a certainty" that credit card late fees constitute "interest" within the meaning of Section 85. The question of preemption, however, "is basically one of congressional intent. Did Congress, in enacting the Federal Statute, intend to exercise its constitutionally delegated authority to set aside the laws of a State?" *Barnett Bank*, slip op. 4. It is not governed by the kind of rigid rule proposed by petitioner.

The test for preemption proposed by petitioner is particularly unsuited to the resolution of the question presented in this case. This Court's search for legislative intent has been informed by the well-founded assumption that Congress does not ordinarily seek to broadly displace historic state functions. When that is the consequence of preemption, the Court has sometimes looked for a "clear and manifest purpose" to preempt. *Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 516 (1992); *Rice*, 331 U.S. at 230.

Section 85, however, does not affect a State's general power to regulate commercial lending practices. Instead, it governs only the activities of national banks. A national bank is an "instrumentalit[y] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." *Marquette*, 439 U.S. at 308. Because of the important public function they perform, Congress has long treated national banks as "National favorites." *Tiffany*, 85 U.S. (18 Wall.) at 413. It would be inconsistent with that tradition to require proof to a certainty that Congress intended to preempt a particular state law insofar as it affected national banks. It is therefore not surprising that this Court has decided preemption questions under the National Bank Act without invoking the interpretive principle relied on by petitioner. See *Barnett Bank*, slip op. 4-11; *Marquette*, 439 U.S. at 313-319. Petitioner's state-protective interpretive rule is especially out of place in interpreting Section 85, since Congress enacted that provision with the specific purpose of protecting

national banks from "unfriendly State legislation." *Tiffany*, 85 U.S. (18 Wall.) at 412.

Petitioner's proposed preemption test suffers from an additional defect. Under *NationsBank*, the Comptroller has authority to decide whether a particular charge is interest when Congress's intent is not clear. 115 S. Ct. at 813. Under petitioner's proposed test, however, that very lack of clarity would automatically mean that the particular charge was not interest. Petitioner's approach therefore would deprive the Comptroller of the authority granted by Congress to fill in the gaps in the National Bank Act through regulation and interpretation, a role that does not disappear simply because the Comptroller's interpretation might have the effect of preempting state law. See *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 170 (1982) (holding that a regulation of the Federal Home Loan Bank Board preempted contrary state law, even though the governing federal statute did not speak directly to the issue resolved by the regulation); see also 12 U.S.C. 43 (requiring the Comptroller to give notice and seek public comment before issuing an opinion letter or interpretive rule that has the effect of preempting state consumer protection law).

The question whether late fees are interest within the meaning of Section 85 is therefore governed by ordinary principles of statutory construction and administrative deference. As we have shown, that conventional approach leads to the conclusion that late fees are interest under Section 85.

CONCLUSION

The judgment of the Supreme Court of California should be affirmed.

Respectfully submitted.

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MARCH 1996

APPENDIX A

12 U.S.C. 85 provides:

§ 85. Rate of interest on loans, discounts and purchases

Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Revised Statutes. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, prov-

ince, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

APPENDIX B

12 C.F.R. 7.4001 [61 Fed. Reg. 4869 (Feb. 9, 1996)] provides:

§ 7.4001 Charging interest at rates permitted competing institutions; charging interest to corporate borrowers.

(a) *Definition.* The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

(b) *Authority.* A national bank located in a state may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state. If state law permits different interest charges on specified classes of loans, a national bank making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest. For example, a national bank may lawfully charge the highest rate permitted to be

charged by a state-licensed small loan company, without being so licensed, but subject to state law limitations on the size of loans made by small loan companies.

(c) *Effect on state definitions of interest.* The Federal definition of the term "interest" in paragraph (a) of this section does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not "interest" under state law where a national bank is located but state law permits its most favored lender to charge late fees, then a national bank located in that state may charge late fees to its intrastate customers. The national bank may also charge late fees to its interstate customers because the fees are interest under the Federal definition of interest and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.

(d) *Usury.* A national bank located in a state the law of which denies the defense of usury to a corporate borrower may charge a corporate borrower any rate of interest agreed upon by a corporate borrower.

12 C.F.R. 7.4002 [61 Fed. Reg. 4869-4870 (Feb. 9, 1996)] provides:

§ 7.4002 National bank charges.

(a) *Customer charges and fees.* A national bank may charge its customers non-interest charges and fees, including deposit account service charges. For example, a national bank may impose deposit account service charges that its board of directors determines to be reasonable on dormant accounts. A national bank may also charge a borrower reasonable fees for credit reports or investigations with respect to a borrower's credit. All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.

(b) *Considerations.* The establishment of non-interest charges and fees, and the amounts thereof, is a business decision to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A bank reasonably establishes non-interest charges and fees if the bank considers the following factors, among others:

(1) The cost incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accordance with the bank's marketing strategy; and

(4) The maintenance of the safety and soundness of the institution.

(c) *Interest.* Charges and fees that are "interest" within the meaning of 12 U.S.C. 85 are governed by § 7.4001 and not by this section.

(d) *State law.* The OCC evaluates on a case-by-case basis whether a national bank may establish non-interest charges or fees pursuant to paragraphs (a) and (b) of this section notwithstanding a contrary state law that purports to limit or prohibit such charges or fees. In issuing an opinion on whether such state laws are preempted, the OCC applies preemption principles derived from the Supremacy Clause of the United States Constitution and applicable judicial precedent.

(e) *National bank as fiduciary.* This section does not apply to charges imposed by a national bank in its capacity as a fiduciary, which are governed by 12 CFR part 9.

APPENDIX C

Feb 24, 1955

Reference is made to the question submitted at the recent examiners' meeting by National Bank Examiner L. Dale Shaffer, relating to charges made by some banks in Pennsylvania when the payments on installment loans are extended.

The Pennsylvania Small Loan Act, known as Act No. 70, as amended, may be found in Purden's Pennsylvania Statutes Annotated, Title 7, section 819-1001, subparagraph A(4). The Act specifies that the permissible charge on an installment loan is a principal amount not exceeding $3,500, covering a period not exceeding three years, shall be at a rate not exceeding $6 per $100 per annum upon the original face amount of the loan for the entire period of the loan, which may be collected in advance. The Act also provides:

> ". . . No additional amount shall be charged or contracted for, directly or indirectly, on or in connection with any such installment loan, except the following: (a) Delinquency charges not to exceed five cents for each dollar of each installment more than fifteen days in arrears: Provided, That the total of delinquency charges on any such installment loan shall not exceed fifteen dollars, and only one delinquency charge shall be made on any one installment; . . ."

Under the above quoted exception in the law, state banks in Pennsylvania, and therefore national banks under the authority contained in Section 5197 of the Revised Statutes (12 U.S.C. 85) may make a delinquency charge within the permissible limits when monthly installment loan payments are extended.

Very truly yours,

/s/ L. A. JENNINGS
L.A. Jennings
Deputy Comptroller of
the Currency.

APPENDIX D

Jun 25 1964

Mr. David Swankin
Executive Office of The President
President's Committee on Consumer
Interests
Room 183
Washington, D. C.

Dear Mr. Swankin:

In your letter of May 22, 1964, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by

some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each questioned transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be please to furnish such information upon request.

Sincerely,

/s/ JAMES J. SAXON
James J. Saxon
Comptroller of the
Currency

WOM:dm 5/26/64

(6)

Supreme Court, U.S.
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No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

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I. PRELIMINARY STATEMENT

To understand why penalty charges do not constitute § 85 "interest at the rate," an understanding of what charges may be "interest" is necessary. There is no dispute that the § 85 term "interest" may include a number of different types of charges irrespective of the form or the label. For example, "interest" may include flat charges that the borrower is *required* to pay to obtain a consensual loan or forbearance, such as up-front closing fees, taxes, recording fees, or bonuses. All of these up-front charges can be amortized over the loan term (or one year) to calculate an interest rate for the loan or forbearance. The term "interest" may also include "damages" paid after a loan default, such as back-end charges to compensate the lender for the time value of its money. But contract penalties like a $15.00 late fee are not interest in the nature of damages because they are neither based on the unpaid balance nor measured by time. *See Meilink v. Unemployment Resources Comm.*, 314 U.S. 564, 570 (1942) (the distinction of a "penalty as a fixed *ad valorem* amount taking no account of time, and interest which does depend on time, is persuasive.").

While interest in the nature of damages may take many forms, for a charge to constitute a "rate" of "interest," there must be some connection between the amount of the charge and both the delay time and the unpaid balance. Where a sum-certain default charge is contingent (not required for the loan or forbearance) and is not related to time or the unpaid balance (not a ratio charge), it is a contract penalty rather than interest in the nature of damages. This Court has often recognized this distinction. *See United States v. Childs*, 266 U.S. 304, 309 (1924) ("a penalty is a means of punishment; interest a means of compensation"). A penalty charge will exist where there is "no account of time" but interest, by contrast, must take account of time. *Meilink v. Unemployment resources Comm.*, 314 U.S. at 570. Indeed, at common law, penalty charges were against public policy and unenforceable.

Kothe v. R. C. Taylor Trust, 280 U.S. 224, 226 (1930) ("But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced").

Smiley, 11 Cal. 4th 138, 4 Cal. Rptr. 441, 900 P.2d 690 (1995) failed to make any distinction between penalty charges and so-called flat or percentage charges for a loan default measured by time and based on the unpaid balance. Judge Arabian (dissenting) correctly addressed the issue whether "late payment penalties" constitute "interest." 900 P.2d at 708-716. Judge George (dissenting) also correctly addressed the issue whether the "type of late payment fees at issue in the present case" constitutes § 85 "interest." *Id.* at 716-720. Unlike the succinct views of Judge Arabian and Judge George, the *Smiley* majority failed to recognize the distinction between contract penalties and interest in the nature of damages following a loan default which was both measured by time and based on the unpaid balance.

Smiley instead held that "We cannot find the meaning of the term 'interest' in Section 85 itself. The provision simply does not define the word." *Id.* at 697. *Smiley* next considered "the source of Section 85 which is Section 30 of the National Bank Act." (*Id.*) and concluded that "Looking at the National Bank Act itself we find no express definition of the terms 'interest' in Section 30. The provision itself does not offer a meaning. Neither does any other." *Id.* at 698-99. *Smiley* erred with respect to all three conclusions.

The Primary Issues That Might Be Decided In This Case

One legal issue to be resolved is whether the § 85 term "interest at the rate" includes contract penalties. Amici submit that while the federal term "interest" may include time-based charges for damages, it does not include contract penalties that lack a "rate" relationship either to time or to the unpaid balance of a loan. Another issue is whether the § 85 term "rate" limits the term

"interest" to detention charges that can be expressed as a "rate of interest." The term "rate" is used ten times in § 85. The term "interest" is used only four times. The term "interest" does not appear even once in § 85 without the term "rate." Accordingly, not all forms of "interest" in the "nature of damages" are allowed by § 85. Only those forms of "interest" that can be expressed as a "rate" are authorized by § 85.[1]

The longstanding common law distinctions between interest rates as damages and contract penalties do not prevent national banks from charging late fees to deter or punish a breach of contract. If a bank's home state permits or limits the contract default charges, then national banks may impose those same contract default charges in their home states as a matter of contract law. The default charges are not, however, "interest" and cannot be exported under the federal definition of "interest" in § 85. Instead, the default charges remain contract default charges authorized by Section 24 (Third) of the National Bank Act, 12 U.S.C. § 24 (Third), which allows banks to "make contracts." Each state may regulate the default charges even-handedly against both in-state and out-of-state lenders. In fact, Section 24 prohibits states from discriminating against national banks. *See, e.g., First Nat'l Bank v. California*, 262 U.S. 366 (1923). In this way, state regulation of contract default charges by a borrower's state does not and cannot subject a national bank to less

[1] The term "interest rate" therefore has one or more of three characteristics: (i) it is required for the loan and/or (ii) based on the unpaid balance and/or (iii) measured by time. "Flat" up-front charges and interest in the nature of damages, *i.e.*, measured by time and based on the unpaid balance, have one or more of these loan characteristics. Default charges in the "nature of damages" therefore may be interest. But contract penalties which are not based on time and the unpaid balance lack all three interest characteristics and were not "interest" at common law.

favorable conditions than those available to other lenders in the borrower's state.

II. INTEREST OF AMICI

The National Association of Consumer Advocates, Inc. ("NACA") is a non-profit corporation formed in response to the widely expressed belief that an organization of private and public sector attorneys, legal services attorneys, law professors and students, whose primary practice involved the protection and representation of consumers, was needed.

The National Consumer Law Center, Inc., is a non-profit corporation established in 1969 to carry out research, education and litigation involving significant consumer issues. The activities of the National Consumer Law Center, Inc., include research, providing expert and technical assistance on consumer law issues for legal services, pro bono, government and private attorneys. It publishes a twelve-volume series of consumer law treatises, including *The Cost of Credit: Regulation and Legal Challenges* (1995).

Amici submit this brief in support of Petitioner Barbara Smiley. The California Supreme Court's September 1, 1995 divided opinion in *Smiley* presents issues of profound importance to the states and to credit card holders across the country. *Smiley*'s definition of "interest" and subsequent preemption analysis will wreak havoc on state consumer protection laws and will adversely affect millions of consumers. This Court should not allow the South Dakota legislature to nullify California law designed to protect its residents.

III. LEGAL ARGUMENT

I. THE PLAIN MEANING OF "INTEREST" EXCLUDES PENALTY CHARGES

Congress did not explicitly define the term "interest" in § 85 but the meaning of that term may be determined from the following:

- How "interest" was used in the extensive legislative debates that preceded and accompanied the National Bank Act of 1864;
- How "interest" was used by Congress in other provisions of the National Bank Act in 1864 and in the various amendments enacted thereafter;
- How "interest" was defined at common law;
- The common law holdings of this Court (and other courts) that "penalty charges" are not "interest";
- This Court's rulings that Congress must have intended a "strict" and "literal" definition of "interest" so as to avoid subjecting the fledgling national banks to the severe usury penalties of Section 30 (now §§ 85 and 86) of the Act; and
- How the undefined term "interest" was used by Congress in all other known pre-1980 Congressional acts.

Disregarding these definitional sources, *Smiley* relied on non-§ 85 cases to hold that "interest" in § 85 included *all* charges, in any form." *See Smiley*, 900 P.2d at 702-703. While "interest" may indeed include different types and forms of charges, it has never included "all charges, in any form." The common law authorities cited by *Smiley* only hold that interest may include charges in the "nature of damages" for the detention of money. In each and every cited authority, the damages were (i) based on an unpaid balance and (ii) measured by time. Neither *Brown*

v. Hiatts, 82 U.S. (15 Wall.) 177 (1873) nor any other known case decided before 1992 has held that "interest" may include a detention charge that is neither (i) based on the unpaid balance nor (ii) measured by time. These two important features, prominently identified in the 1864 legislative debates are pivotal in determining the definition of the § 85 term "interest."

A. The 38th Congress In 1863 Defined The Term "Interest At The Rate" As Loan Compensation Based On The Unpaid Balance And Measured By Time

Section 30 of the National Bank Act, passed in 1864, was virtually identical to the current laws codified as 12 U.S.C. §§ 85 and 86. *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 310 n.23 (1978). Section 30 was preceded by § 46 of the National Currency Act of 1863, 12 Stat. 678, which provided:

> "[E]very association may take, reserve, receive, and charge on any loan, or discount made, or upon any note, bill of exchange, or other evidence of debt, such rate of interest or discount as is for the time *the established rate of interest for delay in the payment of money*, in the absence of contract between the parties, by the laws of the several States in which the associations are respectively located, and no more. . . . "

See 439 U.S. at 310 n.23 (quoting 12 Stat. 678 (emphasis added)). Thus, the Currency Act focused on a time-based *rate* by referring to "interest for delay in the payment of money."

When § 30 of the National Bank Act was passed a year later, the Currency Act's phrase "for delay in the payment of money" was deleted. There is no dispute, however, that the same 38th Congress understood that "rate of interest" itself meant compensation "for the delay in the payment of money." In fact, shortly after passage of § 30 (now § 85), this Court held that "Interest

is given on money demands *as damages for delay in payment*, being just compensation to the plaintiff for a default on the part of his debtor." *Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884). Thus, the time period of delay was always an important feature of the definition of "interest" in the 1800s.

There is no indication that Congress intended "interest" to include charges unrelated to the time "delay" in payment. Nor is there any indication that the term "interest" included special charges beyond those necessary to "compensate" for the time value (delay) of money. If a detention charge did not take account of time (or the amount of the unpaid loan), it was an unenforceable contract penalty.

B. The 1864 Debates Demonstrate That Congress Understood The Section 30 Term "Interest At The Rate" To Be A Charge Based On The Unpaid Balance And Measured By Time

Smiley ignored the 1864 debates and instead adopted a unique interpretation of "interest" in § 85 that is entirely dependent on the law of a bank's home state. *Id.* at 703. *Smiley* candidly admitted that Congress employed the word "interest" in the "sense of a periodic percentage charge." 900 P.2d at 701. But *Smiley* failed to properly consider the legislative history and context despite this Court's reliance on the very same legislative history to determine the meaning of the § 85 term "located." *See Marquette*, 439 U.S. at 314-15 (emphasizing the importance of the legislative history and context). Worse, *Smiley* did not and could not cite *any pre-1992 case* holding that "interest" included penalty charges not measured by time and/or based on the unpaid balance. *Smiley* not only relied on South Dakota state law for its unique definition of interest but also failed to recognize the fundamental differences between interest in the nature of damages and contract penalties. As the 1864 legislative debates conclusively indicate, Congress intended the § 30 term "interest" to mean a numerical rate, allowed or fixed by

state law, measured by time and based on the unpaid balance. *See e.g.*, the statements of Senator Grimes of Iowa, where he stated "Let me tell the Senate how it will operate in the State [of Iowa] . . . [In Iowa] the "legal rate of interest" is "six per cent" but by special contracts the lender can receive "ten per cent." (Ex. 108, p. 2123)[2] Senator Trumbell of Illinois responded that the "law of Illinois" is precisely like that of Iowa." *Id.* Senator Trumbell also recognized that the rate of interest would be "left to the control of [the] legislature." *Id.* at 2124. Senator Conness of California then stated "let the State fix the rate of interest that shall be charged within its borders." (*Id.*) When Senator Doolittle of Wisconsin inquired "What is the rate," Senator Henderson of Missouri responded "Six per cent," *i.e.*, a percentage rate. Senator Sherman of Ohio (one of the Act's sponsors), then responded to Senator Grimes by stating that the "proposed act" takes the laws of Iowa, [i.e., 10 per cent, then 8 per cent, then 6 per cent] (*Id.* at 2125) and presumes that the people of Iowa have sense enough to pass laws to "fix the rate of interest for their own State." *Id.* at 2126.

The 38th Congress also extensively debated whether the terms "established" or "fixed" were the same or different but under *all* views, Congress recognized that under state law, the term "rate of interest" was a statutory numerical percentage rate. *Id,.* at 2125, 2126 (Senators Sherman and Grimes). The 38th Congress also extensively debated and rejected a federal law that would have required a "uniform rate of interest." (*Id.*) Inherent in the concept "uniform rate of interest" is the recognition that a "rate of interest" is susceptible of being "uniform." Penalty charges by definitiion, are not "uniform" throughout the United States and, therefore, could not constitute a "rate of interest."

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[2] Exhibits are contained in the four volume Appendix of Cases submitted to the California Supreme Court in *Smiley*.

Significantly, the term "in the absence of contract" was deleted in the 1864 Act and in its place, the new term "When no rate is fixed by the laws of the state or territory, the bank may . . . charge a rate not exceeding seven per centum, and such interest may be taken in advance reckoning the days for which the note . . . has to run" was added. Congress, by deleting the 1863 term "in the absence of contract", evidenced its intent to further limit the rates allowed under § 30 to statutory rates fixed by the states. Under the 1864 Act, rates "allowed by the laws of the state" or "fixed by the laws of the state" could be charged, i.e., statutory rates. *Tiffany* thus explicitly refers to state "statutes" as the law of the state. Detention charges (either liquidated damages or penalties) were not "established", "allowed" or "fixed by the laws" of any known state in 1864. "Interest" on a debt was "computed upon the amounts then due . . . to the time of payment," i.e., "interest" "accrue[s]." *Richmond v. Irons*, 121 U.S. 27, 64-65 (1887).

Since states in 1864 did not "fix" or "establish" by statute either "damages" or "penalties," the 38th Congress was clearly referring only to a statutory percentage numerical rate when it enacted § 30.

C. The National Bank Act Itself As Enacted In 1864 Also Demonstrates That Congress Did Not Intend To Expand The Term Interest To Include Penalties

The National Bank Act of 1864 itself unequivocally demonstrates that the 38th Congress knew the difference between a "penalty" and "interest," and did not intend the term "interest" to mean "penalties." A "penalty" was a sum certain *not* measured by time or based on the unpaid balance. *See* §§ 1 and 8 of the 1864 Act which required "penalty" bonds from the Comptroller and his deputy and from national bank officers, and § 41, which required a defaulting national bank to pay the government penalties "in the manner in which penalties are to

be collected from other corporations under the laws of the United States."

The 1864 Act also demonstrates that the 38th Congress understood that the term "interest" was a charge measured by time and based on the unpaid balance. See § 21 (referring to "interest at a rate not less than five per centum per annum,"); § 23 (referring to "interest on the public debt,"); § 38 (referring to "interest is past due and unpaid for a period of six months" which could be a "bad debt" in the absence of collection activities) and § 41 (recognizing that "the treasury may reserve the amount of such duties out of the interest, as it may become due on the bonds."). In each and every instance, the 38th Congress in the 1864 Act used the term "interest" to mean a charge both measured by time and based on the unpaid balance. On the other hand, the term "penalty" was uniformly used by the 38th Congress to mean a sum certain greater than the actual loss.

D. The National Bank Act As Thereafter Amended Demonstrates That Congress Did Not Intend To Expand The Term "Interest" To Include Penalties

The National Bank Act as amended after 1864 also demonstrates how Congress intended the terms "interest", "damages" and penalties to be used.[3] "Interest" in the National Bank Act represents a payment measured by time and based on the unpaid balance. See, e.g., § 84(c)(4) (recognizing that "interest" is compensation that may be paid and guaranteed on bonds, notes, certificates of indebtedness or treasury bills of the United States) and § 175 (recognizing that "interest" is paid on bonds.)

[3] An amending Congressional interpretation of a statute is entitled to "great weight". *Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 380-81, n.8 (1969).

On the other hand, the term "damages' is used to connote actual loss. See § 93(a), requiring NBA directors to be responsible in an "individual capacity for all damages." Finally, the term "Penalties", unlike the terms damages or interest, are understood by Congress to require a payment of more than damages. *See* § 71a (recognizing if a state bank which is a member of the Federal Reserve does not have the required number of directors, it is "subject to forfeiture" of its "Federal Reserve Membership"), and § 93(b)(4), (5), (6), (7) and (8), § 161(c) and § 164, all referring to "penalties" in contrast to "damages" as in § 93(a). In other banking statutes, Congress made these same damage/penalty distinctions. *See, e.g.*, 12 U.S.C. § 1818(i), § 1782(a)(3), (d), § 1785(d)(3) and § 1785(g) all using the term "damages", "interest" and penalties differently.

Therefore, in all known National Bank Act post-1864 amendments, Congress used the terms "interest," "damages" and "penalties" quite differently – "interest" represented loan compensation, "damages" represented a remedy based on the actual loss, and "penalties" represented yet a different remedy consisting of a payment greater than the actual loss.

E. *Smiley* Could Not Cite Even One Common Law Case Or Section 30 Case or Pre-1992 Section 85 Case That Even Suggested That The Section 85 Term "Interest" Includes Penalties

Smiley, after it overlooked how the statutory terms "penalty," "damages" and "interest" were used by the 38th Congress both in the 1864 debates and in the text of § 30 itself and how Congress used these three terms "interest," "damages" and "penalties" in the National Bank Act over the next 130 years, proceeded to "Survey[ ] the National Bank Act . . . [and] discovered a basis for inferring an implied interest definition of the term 'interest' in Section 30." 900 P.2d at 699. The "basis" for *Smiley*'s implied definition consisted of primarily two

common law dictionaries and the one decision in *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873). Based on this very limited authority, *Smiley* concluded that under the common law the term "interest" included (1) a periodic charge based on a "percentage of a certain sum, either the amount lent or some other, payable absolutely by maturity." (*Id.* at 699) and (2) "damages for its detention" where the damages consisted of a charge measured by time and based on the unpaid balance. *Smiley* also recognized that at common law "the word interest in § 30 was not so limited" (*Id.* at 699) concluding that a so-called flat fee measured by time and based on the unpaid balance could be "interest" citing *Wernwag v. Mothershead*, 3 Blackford 401 (Ind. 1834). *Id.* at 699.[4]

Smiley, however, then extrapolated its common law interest observations to conclude without any supporting authority that "Section 30 of the National Bank Act should be construed to cover [single sum] late payment fees, if such fees are allowed by a national bank's home state." *Id.* at 700, *i.e.*, a penalty charge of $15 not measured by time and not based on the unpaid balance could be § 30 "interest." In essence, *Smiley* held that the § 30 term "interest" was different then and *broader* than the definitions used by the dictionaries and cases upon which it relied. Contrast the scope of the term "interest" under

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[4] In *Wernwag*, the interest rate was $5 per week on the unpaid balance. The only other case cited by the *Smiley* Court to support its § 30 "interest" that includes "penalty" holding was *Craig v. Pleiss*, 26 Pa. 261 (1856). *Id.* at 699. In *Craig* the Court only considered a charge for a consensual forbearance of a loan not a charge for a detention of money. *Craig* therefore does not support the *Smiley* Court's holding that penalty charges and interest were the same under § 30. In Pennsylvania, as elsewhere, the penalty charges were not considered to be "interest." *See Huling v. Drexell*, 7 Watts 126, 129 (Pa. 1838), *Daly v. Maitland*, 88 Pa. 384 (1879), *Keck v. Bieber*, 148 Pa. 645, 24 A. 170 (1892) and *Hartranft v. Uhlinger*, 115 Pa. 270, 8 A. 244 (1887).

the common law which did not allow penalty charges or even damages except damages in the nature of interest. A penalty unlike "interest" or "damages" by definition is to provide monetary relief "in excess of . . . actual loss." *Scott v. Donald*, 165 U.S. 58, 86, 17 S.Ct. 265, 267 (1897). *Also see City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 260 (1981).[5]

Smiley next attempted to distinguish the numerous common law cases relied on by Petitioner in one of two ways neither of which in fact supported its holding: (1) *Smiley* held that this Court's common law cases relied on by Petitioner did not "define" the term "interest." *Id.* at 699 n.8 and 705 n.15. In each case, however, the Court made it clear that penalty charges were not "interest"; and (2) *Smiley* also held that this Court's other cases relied on by Petitioner like *United States v. Texas*, 507 U.S.

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[5] The *Smiley* Court confuses penalty charges with "compensation for use of money, specifically, its retention, beyond the loan's term," 900 P.2d at 700. Here this Court must assume, as pled, that the charge is a "penalty." Significantly, in recent decisions, California appellate courts have upheld significant damage awards against two other banks, finding that their late fees of a minimum of $3 and a maximum of $5 were penalties because they exceeded the banks' costs reasonably related to collecting and accounting for late payments. *Beasley v. Wells Fargo Bank, N.A.*, 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446 (1991) review denied, 1992 Cal. Lexis 1220 (Cal. March 12, 1992) upheld a jury's award of $4 million in damages to a statewide class of California cardholders because of excessive late fees, and *Hitz v. First Interstate Bank*, 38 Cal. App. 4th 274, 279, 44 Cal. Rptr. 2d 890 (1995) upheld a similar damage award. In both instances, after a trial on the merits, fees of $3-5 were found to far exceed the bank's costs attributable to cardholders paying late. Citibank's fees are five times the other two banks' minimum late fee, and three times the maximum. Without a full factual record, including proof of the costs incurred by Citibank by reason of cardholders paying late, it is impossible to conclude that its fees are not penalites.

529 (1993) did not arise under § 30 and therefore were not relevant. *Id.* at 704. *Smiley*, however, failed to cite a single common law case or § 30 or § 85 case that supported its own unique holding that penalty charges could be considered "interest."

Significantly, as early as 1789, Congress recognized that suits for "penalties" were unique and placed such suits in a category separate and distinct from suits for "interest" and "damages." See the Judiciary Acts of 1789, c 20, § 9 which conferred exclusive jurisdiction in the federal courts over "all suits for penalties and forfeitures incurred under the laws of the United States" (1 Stat 73). Congress was therefore well aware of the difference between the terms "interest" and "penalties" and did not use these terms interchangeably.

F. Under The Common Law Definition Of "Interest," Penalty Charges Were Excluded

The only known § 85 case decided before 1992 concerning whether default charges may be "interest" firmly supports the holding that contract penalties are not § 85 "interest." For example, in surveying the common law of penalties and the statutory principles of usury under § 30 (now § 85), the court in *Merchants Nat'l Bank v. Sevier*, 14 F. 662, 663, 667 (C.C.E.D. Ark. 1882), held that a provision in a note imposing collection costs after a loan default was "a stipulation for a penalty or forfeiture [under common law] . . . and void." *Id.* at 663.

Sevier further holds that while unfair collection costs could not be charged as "interest" by a bank, reasonable costs could be imposed *within* a bank's home state as a matter of contract law. *Id.* at 667 (Circuit Judge concurring). *Smiley* also overlooked the very well-reasoned article by Aldebert Hamilton where he discussed at length why penalty charges were illegal and unenforceable at

common law. *See* 14 F. at 667-75.[6] Since such costs are not interest, each state can limit those costs and thus prohibit both in-state and out-of-state banks from charging excessive contingent fees for a contractual breach. *See, e.g., Aldens, Inc. v. Packel*, 524 F.2d 38 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

It is a "settled principle of statutory construction that, absent contrary indications, Congress intends to adopt the common law definitions of statutory terms." *United States v. Shabini*, ___ U.S. ___, 115 S.Ct. 382, 384 (1994). The 38th Congress was also well aware that "the popular or perceived import of words furnishes the general rule for the interpretations of public laws." *Maillard v. Lawrence*, 47 U.S. (16 How.) 251, 255 (1853). Here, there is no indication Congress intended a unique definition of "interest" and "rate" independent of their common law meaning. Although *Smiley* admitted that under the common law the definition of "interest" excluded penalty charges, it declined to apply a federal definition because the common law cases were not § 85 cases. 900 P.2d at 704. That illogical reasoning cannot withstand scrutiny. If Congress does not define a term in a statute, the primary other source to determine its meaning is the common law. Obviously, to determine the meaning of a newly enacted statute, a court must refer to analogous cases or sources which necessarily will not have addressed that statute.

Indeed, under all known federal statutes, there is a very strong presumption favoring a common law meaning

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[6] *See also Citizens Nat'l Bank of Orange, VA v. Waugh*, 78 F.2d 325, 329-34 (4th Cir. 1935), where the Court recognized that collection costs (if reasonable) were *not* interest because if "it is properly viewed," it is not "a provision for additional interest exacted by the borrower for the use of money . . . but as a provision for indemnifying the lender for the expense to which he may be put by reason of the borrower's default." *Id.* at 329.

for the words used. This Court recently reaffirmed this presumption in *United States v. Texas*, 507 U.S. 529, 534 (1993), a case that also dealt with the meaning of the term interest in a federal statute. The Court in Texas distinguished between interest and penalty charges and found that penalty charges are "more onerous than the common law" of prejudgment interest. *Id.* at 536 ("unlike the common law, § 3717 also imposes processing fees and penalty charges"). In other words, under the common law, penalty charges are not interest.

In this case, there is nothing in § 85 that " 'speak[s] directly' to the question addressed by the common law." *Id.* at 534. Contrary to *Smiley*, "interest" in § 85 should be construed based on the ordinary, common law meaning of the term. *See Perrin v. United States*, 444 U.S. 37, 42 (1979).

Looking to the common law, it is clear that Congress was well aware of the differences between penalty charges and interest when it passed the National Bank Act in 1864. This Court had previously held that penalty charges were not "interest." *See Tayloe v. Sandiford*, 20 U.S. (7 Wheat.) 13 (1822), where this Court recognized that "In general, a sum of money, in gross, to be paid for the nonperformance of an agreement is considered as a penalty." *Id.* at 17. *Also see Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 226 (1830) and *Spain v. Hamilton Adm'r.*, 68 U.S. (1 Wall.) 604, 626 (1863).[7]

[7] Ancient and ecclesiastical law also demonstrates that "interest" and penalties are not the same. At Roman law, the only "interest" that was allowed was that measured by time following a default. In effect, "interesse" (interest) and penalties were the same. But the measure of the "interest" (then called penalty) was based on the unpaid balance and measured by time. Any greater amount was a classic contract penalty ("nomine paenoe"). *See* R. Comyn, *Treatise on the Law of Usury*, pp. 73-74 (R. Pheney, London 1817); *see also Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986). Today, as in Roman times, "interest" following a loan default is likewise limited and must be measured by the *"id quod interest"* standard. Although "interest" for a loan or forbearance is now allowed as well (at Roman times such interest was not lawful), the time measurement for default charges persists. If a time measurement is absent, the default charge is a contract penalty or forfeiture, because the amount is presumed to exceed the time value of money.

At common law, "special damages" that *compensated* the lender for the detention of money in an amount greater than the actual loss were prohibited. For example, in *Loudon v. Taxing District*, 104 U.S. (14 Otto) 771 (1881), the borrower defaulted, requiring the lender to sell his own assets at a substantial discount. The lender sued for the "costs" of the default. The issue was whether the borrower was liable for more than the time-value of the lender's money. This Court held that interest measured by time is the *only* damage allowed. *Id.* at 774. *See also New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (a party "cannot recover special damages for the detention of money due to him beyond what the law allows as interest"). Penalty provisions in contracts (as opposed to tort actions) were generally not enforced where the party was compensated for his loss. *Watts v. Camors*, 115 U.S. 353, 360-61 (1885). *Also see* the Syllabus by Richard Peters, in the Supreme Court Reporter in the case of *Bank of United States v. Owens*, 27 U.S. (2 Peters) 527 n.2 (1829) where he summarized the common law of New York, Massachusetts, Virginia and England and recognized the difference between interest charges and penalties.

Smiley turns the reasoning of *Loudon* and *Piaggio* upside down. Instead of "interest" based on the unpaid balance and measured by time being "the measure of all such damages," it held in essence that "penalties" are the measure of all "interest."

1. Treatises and Other Authorities Uniformly Recognized That The Common Law Term "Interest" Excluded Penalty Charges

Treatise after treatise likewise recognized that "interest" and "penalties" were not the same. In 29 *American and English Encyclopedia of Law 2d* (1904) on "Usury", it is stated that penalty charges (charges within the borrowers' control and, therefore, *not required* for a loan) are *not* usury interest:

> "r. Penalty as Distinguished from Usurious Interest – (a) In General. – Where the statutes prohibit the reservation or taking of interest beyond a certain rate it is generally recognized that there must be an absolute reservation or taking of the excessive interest to constitute usury, and a transaction from which a borrower has the power to relieve himself by the payment of the principal and legal interest within a limited time is not rendered usurious because after such time he cannot free himself without paying more than legal interest. (footnotes omitted) pp. 505-06.

This quote with footnotes cites the law of fifteen states, the United States and England. *Also see* 2 *Parsons on Notes and Bills* 413 (1871).[8]

[8] The term "penalty" like the term "interest" must be interpreted by a federal common law definition. *Contri Smiley*, 900 P.2d at 707-708. Based on the Petitioner's Complaint, it cannot be assumed that Citibank's $15 late fee is simply "compensation for the use of money." *Id.* at 700. Contrary to *Smiley*'s belief, this is not an issue of form over substance, but is of enormous practical importance. *Smiley* incorrectly postulates that a borrower is equally affected by paying $15 in periodic percentage charges or by paying $15 in late payment fees. *Id.* at 706. But in actuality, the late paying cardholder pays *both* a $15 finance charge and a dual, duplicative $15 late fee.

Historically, there can be no serious question that an interest rate was viewed as a charge based on the unpaid balance and measured by time. *See generally*, J. Knox, *A History of Banking in the United States*, (1908). John Jay Knox was Comptroller of the Currency from 1872 to 1884 and author of the Coinage Act of 1873. He reports that Hugh McCulloch, Comptroller of the Currency in 1863, recommended in his report to Congress that "the penalty usury should be a forfeiture of the interest instead of a forfeiture of the debt, and this uniform rate of interest should be seven percent." *Id.* at 233. Significantly, Comptroller McCulloch distinguished between penalties and interest by using the word "penalty" to denote a sum-certain forfeiture but the word "interest" to denote a time-based "rate." By referring to "interest rates" as "percent" charges, the 38th Congress also understood the term "interest rate" to mean a charge measurable by time and based on an unpaid balance. *See id.* at 238-248.

Quite clearly, the different terms "interest" and "penalties" have long been used to connote different concepts.

2. "Interest" In Section 85 Must Be Accorded A "Strict" And "Literal Construction" As Held By This Court

Assuming, as *Smiley* did (and Amici do not), that there is a definition of "interest" that excludes "penalty charges" and a definition that may include "penalty" charges, the Congressionally understood definition must be applied to "interest" in § 85. This Court has held that, because a violation of § 85 subjects a national bank to the "penalty" of forfeiture of double the interest collected, it must "receive a strict, that is literal construction." *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 409, 410 (1874). This Court has also held that a national bank "is not to be subjected to a penalty unless the words of the statute plainly impose it." *Keppel v. Tiffen Sav. Bank*, 197 U.S. 356,

362 (1905).[9] Therefore, even assuming (and Amici do not) that the term "interest" may be defined to include or exclude penalty charges, it is the "strict" and "literal construction" interpretation Congress intended to avoid subjecting the fledgling national banks to the statutory penalty of Section 30 (now §§ 85 and 86) of the National Bank Act that must be applied.

II. THE UNDEFINED TERM "INTEREST" IN OTHER CONGRESSIONAL ACTS EXCLUDE PENALTY CHARGES

Smiley, in essence, held that the § 85 term "interest" is defined unlike any other known congressional use of the term "interest," when undefined to include penalty charges. It apparently believes that the longstanding and consistent Congressional use of the term "interest" to exclude penalty charges in numerous other legislative acts is of no relevance. After extensive research, Amici are unaware of any other pre-1980 federal act where the *undefined* term "interest" was interpreted to include penalty charges. Moreover, this Court, in *Day v. Woodworth*, 154 U.S. (13 How.) 363 (1851) recognized the rarity of a federal statute allowing a penalty. As of 1851, this Court knew of only one such federal statute. *Id.* at 372.

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[9] Under § 85, this Court has recognized the difference between the term "interest" meaning compensation and "penalties" meaning more than actual loss. *See, First Nat'l. Bank v. Morgan*, 132 U.S. 141, 144 (1889):

> A suit against a national bank to recover back twice the *amount of interest* illegally taken by it *is a suit to recover a penalty* incurred under a law of the United States; . . . so far as suits for *penalties* incurred under the laws of the United States were concerned, to modify the provision in prior enactments that expressly excluded suits for such *penalties* from the cognizance of the state courts.

A. Under the Internal Revenue Act, The Undefined Term "Interest" and Penalties Are Not The Same

Congress used the term "interest" in a number of federal statutes after 1864 and before 1980. In construing those statutes, this Court and federal regulators have repeatedly limited the term "interest" to compensation for the use of money to the exclusion of penalties triggered by the borrower's default. For example, in *Deputy v. DuPont*, 308 U.S. 488, 498 (1940) (an IRS case), this Court recognized the ordinary use of the term "interest" generally "means compensation for the use or forbearance of money. In absence of clear evidence to the contrary, we assume that Congress has used these words in that sense." *Also see, Old Colony R.Co. v. Commissioner*, 284 U.S. 552, 561 (1932), ("[T]hat in the common understanding "interest" means what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon."). In short, here, as in *Noteman v. Welch*, 108 F.2d 206, 214 (1st Cir. 1939) "If the loan contract calls for payments by delinquent borrowers for extra expenses of collection resulting from their own default, such payments would not be called interest."

B. Under the Federal Reserve Act, The Undefined Term "Interest" and Penalties Are Not The Same

The Federal Reserve Board has historically defined "interest" for bank deposits to mean:

> [A]ny payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A member bank's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

12 C.F.R. § 217.2(d). By necessity, bank penalties for administrative collection expenses are not interest.

C. Under The Bankruptcy Act, The Undefined Term "Interest" and Penalties Are Not the Same

In the context of bankruptcy, the plain meaning of "interest" also does not include penalty charges. In *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), this Court construed the term "interest" in the Bankruptcy Code. This Court stressed that "[t]he plain meaning of legislation should be conclusive, except in rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." *Id.* at 242. The Court also observed that "interest" is distinct from "fees, costs, or charges." *Id.* at 241 (citation omitted).

D. Under The Truth-In-Lending Act, The Undefined Term "Interest" and Penalties are Not the Same

In the Truth-In-Lending Act (TIL), Congress defined the term "finance charges" (a term that includes interest) to exclude delinquency charges. *See, Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 265-66 (3d Cir. 1975), where the court defined the pre-TIL congressional understanding of the term "default charges" as follows:

> Prior to enactment of the Act, the terms "default charges" and delinquency charges" had well established meanings in the commercial credit field and in other consumer credit legislation, *and it is certain that Congress was well aware of these definitions.* Since the legislative history of the Act indicates that Congress intended to enact remedies that reflected commercial realities, we presume that Congress meant to ascribe to the terms "default charges" and "delinquency charges" the generally accepted meanings of these terms in the consumer credit industry.

There are numerous other facets of *Johnson* that are particularly relevant. In enacting the Truth-In-Lending Act, Congress recognized that "interest" and "delinquency charges" were mutually exclusive. To state this another way, there is *no* overlap between what Congress considered an "interest" charge (which is part of the "finance charge") and what Congress considered a "delinquency charge."

E. The Undefined Term "Rate" Excludes Single Sum Penalty Charges

It is clear that from 1864 to at least 1980, Congress consistently used the undefined terms "interest" and "rate" to exclude penalty charges.

Recently, in the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub.L. No. 103-328, 108 Stat. 2338 ("Reigle-Neal Act"), which governs national banks Congress once again made it clear it intended to preserve, not preempt, state consumer protection laws. The Conference Report that accompanied this Act recognized:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, ...

H.R. Report 103-651, 103d Cong. 2d Sess. 53 (1994).

In this same Act, Congress highlighted its use of the different statutory terms "rate" and "amount." In § 113 of the Reigle-Neal Act, Congress amended the "interest rate" language pertaining to certain agricultural loans covered by the Consolidated Farm and Rural Development Act, 7 U.S.C. § 1927(a). Instead of referring just to "rate of interest", Section 113 is now broader in scope and provides: "Notwithstanding the provision of the constitution or Laws of any state limiting the rate *or amount* of interest. . . . " (emphasis added). Congress thus extended the preemption it intended for those agricultural loans *both* to rates and to flat

"amounts".[10] Congress simultaneously emphasized in § 111(3) that no amendment in the Reigle-Neal Act, including the new language of § 113, was to be construed "as affecting in any way . . . the applicability of § 85." Congress, therefore, codified and highlighted the material differences in scope among § 85 on the one hand, and the new § 113 on the other hand. Accordingly, the Reigle-Neal Act provides yet another indication that Congress considered but elected not to amend § 85 to apply to the "amount" of loan charges but instead consciously limited the scope of § 85 to "rates."[11]

III. NO DEFERENCE IS OWED THE STAFF OPINIONS OF THE OCC

The OCC staff has over the years taken very different and inconsistent positions as to the scope of the § 85 term interest. Pre-February 1995, the OCC staff argued that the § 85 term "interest" could be uniquely defined by each of the fifty state legislatures. After February 1995, it has opined that the § 85 term "interest" has a federal definition which it

[10] Historically, when Congress intended to preempt flat charges, instead of only "rate", it explicitly stated so in the banking law. *See* 12 U.S.C. § 1735(f)-7a(a)(i) (§ 501 of DIDA), preempting in addition to "rates" "amounts"; *see also* 12 U.S.C. § 1735f-7(a) (§ 529 of DIDA) preempting any "amount of interest" in addition to "rate". Because § 85 preempts only a "rate" of interest", *not* amounts of interest, the statute does not preempt flat charges, but only rates.

[11] In addition, "interest at the rate" in § 85 should be construed no more broadly than the associated § 85 term "discount rate" in the same sentence. *See Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). Since discount interest (which is collected at the outset of a loan) does not include contingent charges, "rate of interest" likewise cannot include such charges. Moreover, this Court has long recognized that the term "rate" in both terms means the same numerical rate. In short "both are expressly made subject to the same rate of interest." *National Bank v. Johnson*, 104 U.S. 271, 277 (1881).

alone can determine. To support its recent 1996 federal definition, the OCC nonsensically relies on pre-1996 staff opinions and case law that erroneously accorded the § 85 term "interest" a state definition.

A. Pre-February 1, 1995 OCC Staff Opinions Were Based On The Erroneous Belief That State Law Determined The Scope of The § 85 Term "Interest"

The *first* time the OCC staff considered a single sum penalty charge (*i.e.*, a penalty) to be interest was in the August 1988 opinion of Mr. Serino, OCC Deputy Chief Counsel, where he stated that, in *his opinion* (not the opinion of the OCC), under a *state law* definition of "interest," a single sum late fee, (*i.e.*, a penalty) could be interest under § 85. Mr. Serino stated "it is my position" that penalties, even "attorneys' fees," are "interest" under the now discarded contention that the § 85 term "interest" could be defined by each of the fifty state legislatures. OCC Letter No. 452, R. Serino, Deputy Chief Counsel. Reprinted in [1988-89 Transfer Binder] Fed. Banking L.Rep. (CCH) #85, 676 at page 78065-67 (Aug. 11, 1988).

This staff opinion and others of similar ilk are now entitled to no weight because they are based on the erroneous belief that each of the state legislatures can uniquely define and redefine the § 85 term "interest." Moreover, this OCC staff position that § 85 "interest" is defined by the law of the bank's home state – has now been rejected by both Citibank and the OCC itself. In any event, the position of the OCC staff does not necessarily represent the position of the OCC itself. *See NationsBank, N.A. v. Variable Annuity Life Ins. Co.*, 115 S.Ct. 810, 816 (1995).

B. The One Post-February 1995 OCC Opinion – While Purporting To Apply A Federal Definition Of "Interest" – Improperly Relied On Staff Opinions And Case Law That Applied A State Definition

Prior to February, 1995 the opinion of the OCC itself was that penalty charges were not § 85 "interest." *See, e.g.*, the

interpretive letters issued by the Comptroller of the Currency, James J. Saxon. In 1964, Mr. Saxon issued a letter that addressed the meaning of "interest" in 12 U.S.C. § 85 and stated that "*Charges for late payments . . .* are illustrations of charges which are made by some banks which *would not properly be characterized as interest.*" OCC Letter, Saxon, J. (June 25, 1964) (emphasis added). (Petitioners' Brief, Ex. B) *Smiley* seemed to believe that the OCC staff letters (stating that a national bank's home state law defined the scope of the § 85 term "interest") represented the position of the OCC but that the opinions of the Comptroller of the Currency himself did not. *Id.* at 702 and 703, n.13.

On February 17, 1995, Julie L. Williams, Chief OCC Counsel, became the first OCC staff employee on behalf of the OCC itself to reject the state law definition of § 85 "interest" theory. *See Smiley*, 900 P.2d at 702. As a result, decisions by courts, the O.C.C. staff and other agencies relying on Mr. Serino's earlier erroneous belief that state law determines the scope of § 85, are entitled to no weight.

The February 1995 Williams' letter, however, is entitled to little, if any, weight for at least three reasons: (1) it relied almost exclusively on case law and staff opinions that used a state not federal definition of § 85 "interest"; (2) it concluded that the § 85 term "interest" must be interpreted broadly and ignored this Court holdings that § 85 "interest" should be interpreted "strictly" and "literally", so a National Bank can avoid the § 86 penalty. *See Tiffany*, 85 U.S. at 410 and *Keppel v. Tiffen Savings Bank*, 197 U.S. at 362; and (3) it relied on cases holding that up front required charges like bonuses, commissions, and charges for mortgage taxes and recording fees are examples of § 85 "interest" when the OCC has since stated that such up front costs may *not* be "interest."[12]

[12] Moreover, the definition of "interest" in the § 85 cases relied upon by *Smiley* was never in dispute. In these cases since the parties and Courts simply assumed the charge was § 85 "interest", these cases have no precedential value as to the definition of § 85 interest. *See generally Zenith Radio Corp. v. United States*, 437 U.S. 443, 459-62 (1978).

Significantly, less than one month after the Williams' letter, the OCC issued a proposed interpretive rule disagreeing with Williams' "broad" definition of "interest" and concluding that § 85 "interest" does *not* ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of an extension of credit, finders fees, fees for document preparation or notarizations, or fees incurred to obtain credit reports." *See* 60 Fed.Reg. 11924-11941 (March 3, 1995).[13] Based in part on the OCC's pre-March 3, 1995 position, *Smiley* erroneously concluded that § 85 included all "credit terms," which is clearly inconsistent with the OCC's 1996 definition of the § 85 term "interest."

IV. THE STATES MAY REGULATE A NATIONAL BANK'S TRANSACTIONS WITH STATE RESIDENTS

This Court has long upheld the right of the states to non-discriminatorily regulate national banks insofar as their transactions with state residents. *See, e.g., McClellan v. Chipman*, 164 U.S. 347 (1896) (state fraudulent conveyance statute not pre-empted), *First National Bank v. Missouri*, 263 U.S. 640, 656 (1924) (state statute prohibiting branch banking prohibitions not pre-empted (pre-McFadden Act)), *Lewis v. Fidelity & Deposit Co. of Maryland*, 292 U.S. 559 (1934) (state statute regulating bank guaranties not pre-empted), and *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944) (state statute requiring escheat to state

[13] On February 9, 1996, the OCC issued its final regulation adopting its new re-definition of § 85 "interest." That OCC regulation will become effective on April 1, 1996. *See* 61 Fed. Reg. 4849-4870 (1996).

of bank deposits not pre-empted). *Also see Citizens Nat'l Bank v. Donnell*, 72 S.W. 925, 931-32 (1903), *aff'd., Citizens Nat'l Bank v. Donnell*, 195 U.S. 369 (1904) (state requirement of a writing prior to charging a higher rate of interest not pre-empted), *New Hampshire Banker's Association v. Nelson*, 336 F.Supp. 1330 (D.N.H. 1972) (state laws regulating bank advertising not pre-empted) and *National State Bank, Elizabeth N.J. v. Long*, 630 F.2d 981 (3d Cir. 1980) (state redlining loan laws regulating national banks not pre-empted). Thus, states can and do regulate a number of national bank transactions within their own boundaries, including a national bank's debt collection activities. *See, National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1870). Thereafter, this Court in *First Nat. Bank of Charlotte v. Nat. Bank of Baltimore*, 92 U.S. 122, 127 (1875) explicitly recognized with respect to debt collections that a national bank is only allowed the same state rights as a natural person:

> Obligations may be assumed that result unfortunately. Loans or discounts may be made that cannot be met at maturity. Compromise, to avoid or reduce losses are oftentimes the necessary results of this condition of things. These compromises come within the general scope of the powers committed to the Board of Directors and the officers and agents of the bank, and are submitted to their judgment and discretion, except to the extent that they are restrained by the charter or by-laws. *Banks may do, in their behalf, whatever natural persons could do under like circumstances.* (emphasis added).

Also see, Miller v. King, 223 U.S. 505 (1911), where this Court stated that a national bank "[M]ay do those acts and occupy those relations which are usual or necessary in making collections of commercial paper and other evidences of debt" and upheld the national bank's right to file suit on an assigned judgment in a manner allowed by Oregon state law. *Id.* at 510-511.

All parties agree that a National Bank is a "most favored lender" under § 85. Here, however, the well established Congressional policy of "competitive equality" controls and prohibits national banks from exporting non-interest charges (i.e., penalty charges) under § 85 into other states. *See generally, First National Bank v. Dickinson*, 396 U.S. 122, 138 (1969), and *First Nat. Bank of Logan v. Walker Bank & T. Co.*, 385 U.S. 252, 261 (1966) where the Court held that "nor is the Congressional policy of competitive equality with its deference to state standards open to modification by the Comptroller of the Currency" (footnote omitted).

In light of the above, Petitioner's home state can regulate or limit penalty charges as part of California's police power to regulate debt collection activities.

V. CONGRESSIONAL PURPOSES UNDERLYING § 85 ALSO MITIGATE AGAINST AN INTERPRETATION OF THE § 85 TERM "INTEREST AT THE RATE" THAT INCLUDES PENALTY CHARGES

Congress as evidenced by the language of the National Bank Act (§ 85) developed a statutory scheme that protects borrowers in at least four ways: (1) it enables states to protect resident borrowers with respect to penalty charges and other onerous, non-interest charges like attorneys' fees; (2) it enables resident borrowers to retain the benefits of state consumer protection laws that do not regulate both the "interest" and the "rate," but only "amounts" of *non*-interest loan charges that can be imposed; (3) it enables resident borrowers to compare and shop rates of interest based on uniform federal definitions of "interest," and "rate" before they agree to a reservation of interest; and (4) it maintains "competitive equality" between state leaders and national banks.

Moreover, the definitions of § 85 "interest" and "rate" adopted by Congress protects national banks because: (1) it allows national banks to impose penalty charges and attorneys' fees on the same basis as any other lender

within each state by providing § 24 (Third) which has been interpreted to prohibit discrimination against national banks; (2) it is in accordance with this Court's holding that § 85 should be interpreted "strictly" and "literally" to avoid subjecting national banks to statutory penalties; (3) it provides national banks an objective federal § 85 "interest" standard that is not subject to the ephemeral views of the states or the OCC so that national banks can rely on a firm standard; and (4) most significatly it carries out the intent of Congress, as evidenced by the "interest" and "rate" language of the statute itself and the pre-1992 case law all recognizing the difference between the terms "penalties", "interest" and "rates."

CONCLUSION

For the reasons stated above, Amici respectfully request this Court to uphold the position of Petitioner Barbara Smiley, and reverse the lower Court.

Respectfully submitted,

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No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

AMICUS CURIAE BRIEF OF CONSUMER ACTION IN SUPPORT OF PETITIONER SMILEY

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37pp

QUESTIONS PRESENTED

1. When Congress enacted Section 30 of the National Bank Act of 1864, 12 U.S.C. § 85, ("section 85") which allows national banks to charge "interest at the rate" allowed by the state in which they are located and thereby preempts other states' limitations on the interest rates that national banks may charge, did Congress intend that section 85 would also preempt state statutes enacted for the protection of consumers that restrict or regulate *non-interest* charges, including contingent penalty fees such as the credit card late payment fees at issue in this action?

2. If Congress did not intend section 85 to preempt state consumer protection statutes that regulate contingent penalty charges and other non-interest terms, did Congress intend to delegate to the various states the right to expand the preemptive scope of section 85 by creating broad, all-inclusive definitions of the term "interest"?

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INTEREST OF AMICUS[1]

Consumer Action is a non-profit, membership consumer education and advocacy organization, based in San Francisco, California. The organization was established 23 years ago and currently has more than 1400 members. As a service to consumers and community organizations in California and elsewhere, Consumer Action publishes and distributes approximately 1 million pieces of literature per year, free of charge, in eight different languages, on banking, credit and utility issues, including an annual survey of bank credit card interest rates and fees. In addition, the organization is a member of the Consumer Federation of America, and is actively involved in policy development, research, and legislative advocacy on credit and banking issues on behalf of consumers at both the state and national levels.

Consumer Action has a long-standing interest in this litigation because the issue presented has profound significance for consumers in California and throughout the country. Consumer Action monitors the credit card industry on behalf of its members and other consumers, and advocates against excessive penalty fees imposed by credit card issuers, and other unfair, deceptive or punitive practices of card issuers that affect consumers. This Court's reaffirmance that states have the right to legislate consumer protections in the area of credit penalty fees is vital to Consumer Action's efforts to advocate on behalf

[1] Pursuant to Supreme Court Rule 37.2, copies of letters expressing the written consent of the parties to the filing of this brief on behalf of *amicus curiae* Consumer Action are filed separately herewith.

of consumers at both the state and federal level. Accordingly, Consumer Action submits this brief in support of Appellant Smiley, and urges the Court to reverse the decision below of the California Supreme Court.

INTRODUCTION

The issue presented for review in this Court is whether Section 30 of the National Bank Act, 12 U.S.C. § 85, (hereinafter "section 85") which allows national banks to charge "*interest* at the *rate* allowed" (emphasis added) by the state in which they are located, includes within the term "interest . . . rate" credit card penalty charges, in this case late fees, that are imposed for minor breach of contract separate from and in addition to interest, such that California's regulation of such charges is preempted for out-of-state national banks, including Respondent Citibank, chartered in South Dakota. In particular, the issue is whether section 85 permits national banks that choose to locate in "deregulated" states, such as South Dakota, Ohio, and Delaware, states which have revoked consumer protection statutes and created an environment favorable to banking interests, to "export" contingent penalty charges allowed in their home states to consumer credit card customers solicited in other states in which such charges are prohibited, or otherwise limited or regulated, by common law or consumer protection statutes.

As will be addressed at length by petitioner Smiley, penalty fees, including late payment fees and over-credit-limit fees, are not "interest" under any mode of interpretation, whether it be the plain and ordinary meaning

of the term, or its historical or common law interpretation. Penalty fees are imposed upon a *breach* of the credit card contracts for a deterrent or punitive purpose, *and are imposed entirely separate from and in addition to* the already substantial, and continually accruing, interest rate charges. Nevertheless, in a sharply divided opinion below, the majority of the California Supreme Court held that the term "interest" could be construed broadly to include late fees, and therefore section 85 preempts limitations on credit card penalty fees applicable under California law. *Smiley v. Citibank*, 11 Cal.4th 138, 44 Cal.Rptr.2d 441, 900 P.2d 690 (1995). Consumer Action submits that the decision below is wrong, and should be reversed by this Court.

SUMMARY OF ARGUMENT

As the Court reviews the legal issue presented in this case, *amicus* Consumer Action respectfully suggests that the Court should also consider the important economic context in which the issue arises, and the serious negative ramifications for consumers that are likely to result from a ruling upholding the broad preemption analysis of the California Supreme Court. In the lower courts in this action, and in other actions around the country in which the same preemption issue has been litigated, some banks and their *amici* have implied that the underlying dispute in the action is relatively unimportant because credit card late payment fees are essentially *de minimis* charges that have little or no real impact on "good" consumers. The banks have also suggested that their profitability depends on the imposition of late payment and other non-interest fees, and therefore a decision in favor of the banks is

necessary to protect them from economic harm. As will be discussed in this brief, both of these notions are belied by the economics of the credit card industry, including its increasing dominance in the consumer economy and its extraordinary profitability, and the true cost to consumers of increasingly excessive penalty fees.

Moreover, the issue presented in this case is not simply about credit card late fees; rather it is fundamentally about the right of the states to legislate on behalf of consumers on banking issues, a power traditionally reserved to the states, and to enforce such duly-enacted consumer protection statutes against all banks, whether national or state-chartered, that choose to solicit and to profit from the state's consumers. This Court's resolution of the preemption issue will not only impact on the ability of the states to protect consumers from excessive and unfair credit card penalty fees, but will also have an impact on many other consumer credit card and banking practices in which the states have, or may in the future, legislate protections on behalf of consumers. Accordingly, for the reasons set forth below, Consumer Action respectfully urges the Court to reverse the decision of the California Supreme Court, and to reaffirm that states have the power to enforce their duly-enacted consumer protection statutes regulating credit card penalty charges.

ARGUMENT

I. THE NATURE OF THE CREDIT CARD INDUSTRY DEMONSTRATES THE IMPORTANCE OF STATE CONSUMER PROTECTION LEGISLATION REGULATING PENALTY CHARGES.

As is addressed below, there are at least five salient facts about the credit card industry in the United States that are relevant to the issue presented in this case, and that should provide a important factual context for the Court's consideration of the legal issue presented.

1. *The credit card industry has grown exponentially in the past 15 years* in every measurable aspect, including the number of consumers holding credit cards; the number of credit cards held by the average consumer; the number of credit card transactions made each year; and the total amount of credit card debt carried by American consumers.

2. Although there are thousands of credit card issuers, *the industry is dominated by a relatively small number of mega-issuers located in small, deregulated states,* such as South Dakota, Delaware, and Ohio.

3. *The credit card industry is phenomenally profitable,* far more so than any other aspect of the banking industry, and has been consistently for at least the past ten years.

4. Although the credit card industry often is characterized as "highly competitive," *competition among issuers generally has focused on non-pricing terms.* With the exception of recent "teaser rate" offers, which revert to the traditional high rates after a specified period, credit card

interest rates have been extremely resistant to competition. There is no evidence of competitive forces at work in the area of penalty charges.

5. Led by the major banks located in deregulated states, *credit card issuers have substantially increased their penalty fees in recent years, including late and over-credit-limit charges,* bringing the fees to average levels of $18 to $20 or more, and resulting in a total annual cost to consumers of approximately $2 billion.

It is within this economic context that a conflict has arisen between states' attempts to enact protections for consumer credit card users, and the mega-issuers attempts to invoke the cloak of federal preemption.

A. The Credit Card Industry Has Grown Exponentially in the Past Fifteen Years and Has Become an Increasingly Dominant Force in the Lives of American Consumers.

Statistics from a variety of sources demonstrate the increasing dominance of credit cards in the United States consumer economy. In general, the industry's startling growth curve over the past fifteen years is evidenced by: (1) a five-fold increase in the volume of charges during the 1980's, (2) a doubling in the number of major credit cards in circulation, and (3) a tripling of the average debt owed by consumers per card.

According to a comprehensive statistical summary published annually by Credit Card Management, outstanding balances on bank credit cards increased by more than 560 percent from 1981 to 1990, growing from $31.8 billion in 1981 to $180.5 billion in 1990. *See* Credit Card

Management, *Card Industry Directory: The Blue Book of the Credit and Debit Card Industry in the United States* (1992 Edition), at 26. During that same time, the charge volume (total dollar amount charged per year) increased on Visa cards from $33 billion to $158.1 billion, and on Mastercards from $26.1 billion to $93.1 billion. *Id.* at 24. These increases represented an average *annual* growth in Visa and Mastercard outstanding balances of 23 and 21 percent, respectively. *See* Paul S. Calem, *The Strange Behavior of the Credit Card Market*, Federal Reserve Bank of Philadelphia Business Review, January/February 1992, at 6. By 1994, the outstanding balances on Visa and Mastercards had reached a record $256 billion, representing yet another increase of at least 24 percent over the previous year. *See* Kelley Holland & Richard Melcher, *Plastic: Are Banks Over Their Limit?*, Business Week, March 6, 1995, at 92. By the end of 1995, outstanding credit card balances had increased again by 19 percent, reaching a total of more than $305 billion. Saul Hansell, *A Shaky House of Plastic With No Quick Fix in Sight*, New York Times, December 28, 1995, at C1.

In 1984, there were approximately 157 million major credit cards in use in the United States. By 1993, that number had risen to an estimated 331 million. *The Global Growth of Credit Cards*, The Futurist, Sept/Oct, 1995, at 53-54. Recent statistics indicate the average cardholder has been adding about one credit card per year, and in 1994, used about 10 different bank, gas and store cards. *See* Linda Stern, *Credit Card Crunch*, Newsweek, February 13, 1995, at 54. Another publication has reported that the average cardholder now carries nine different cards, contributing to the more than one billion credit cards of all types currently in circulation in the United States. *The*

Global Growth of Credit Cards, supra, The Futurist, *supra*, at 54.

The amount of credit card debt carried by consumers also has increased sharply in recent years. Between 1982 and 1989, the average balance carried by consumers in active credit card accounts increased annually at an average rate of 10 percent, climbing to about $1300 at the end of 1989. Calem, *supra*, at 6. In only ten years, the average outstanding balance owed to Visa and Mastercard increased from less than $400 per card in the early 1980s, to almost $1,100 per card in 1993. *Global Growth of Credit Cards, supra*, at 54. Other statistics suggest that the average balance now owed on credit cards has risen to more than $1,700. Stern, *supra*, *Credit Card Crunch*, at 54.

These statistics demonstrate three important trends in consumer use of credit cards in the past fifteen years. *See The Big Squeeze*, The Economist, November 2, 1991, at 13. First, more people than ever before have become credit cardholders, including millions of consumers in lower income brackets, and other categories formerly considered too risky by card issuers. *See* Hansell, *A Shaky House of Plastic, supra*, at C1 (card issuers are aggressively seeking customers who would have been seen as too risky before); *Global Growth of Credit Cards, supra*, (approximately 82 percent of full-time college students have credit cards as a result of aggressive marketing).[2]

[2] *See also* United States General Accounting Office, Report to Congressional Requesters, *U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored*, April 1994, at 13, (hereinafter "1994 GAO Report"), which reported that "[h]igher credit card interest rates enabled issuers to offer cards to riskier customers who previously may not have

Second, consumers now use credit cards much more often than in the past (this is represented by the increase in charge volume). The average household charged $885 per year at the beginning of the 1980s, by 1990, the average household was charging approximately $3,753 per year. *The Big Squeeze, supra*, at 13. Credit cards are now a necessity for many transactions, including car rentals, ticket purchases, and hotel reservations, and can be used in virtually all stores and restaurants, as well as most supermarkets, movie theaters, gas stations, and fast food chains.[3]

The third trend is the increasing debt carried by consumers on their credit cards. In 1980, a typical cardholder owed approximately $350 total debt on all of his or her credit cards; by 1990, that figure had increased to an average of $2,350. *The Big Squeeze, supra*, at 13. *Ibid*. By the end of 1995, it was estimated that the average total credit card debt per household exceeded $3,000. Hansell, *supra*, *A Shaky House of Plastic*, December 28, 1995, at C1.

This ballooning increase in the number of credit cards and the amount of credit card debt carried by consumers is not simply the product of unrestrained

qualified . . . Data also indicate that the percentage of households with at least one credit card account increased in all income groups." The Report showed significant increases in the lower income brackets, including households with less than $10,000 in annual income, and those with $10,000 to $19,999 in annual income.

[3] In light of the fact that credit cards are now required for many transactions, consumers are far more likely to choose a card based on its degree of acceptance and level of service, rather than, as is discussed in Section D below, the penalty fees that might be imposed in the event of breach.

spending by consumers. Rather, the increase is largely the result of a deliberate strategy and massive effort on the part of credit card issuers to solicit more customers, and to encourage higher borrowing by raising credit limits. As will be discussed below, credit card operations are extremely profitable, more so than almost any other sector of the financial industry, leading many issuers to pursue aggressive expansion programs.[4] The *New York Times* reported in December, 1995, that credit card companies sent out nearly 2.7 billion solicitations in 1995, with most households receiving three or four each month. *See* Hansell, *supra*, at C1. It is important to note in this respect that because the primary source of profit in the industry is annual percentage rate (APR) revenue, the most profitable, and therefore most desirable, customers are the higher risk "borrowers," i.e., those who carry a high balance, and not the "convenience users," i.e., those who pay off their balance every month. *See e.g.* Lawrence Ausubel, *The Failure of Competition in the Credit Card Market*, The American Economic Review, March 1991, at 70-71; *A Credit Card Conundrum*, Business Week, January 16, 1995, at 24. Indeed, the safe, low-risk convenience users are considered "dead weight" in the industry. Margaret Mannix, *When Credit Turns Painful*, U.S. News & World Report, November 27, 1995, at 88.[5]

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[4] *See* discussion *infra*. *See also e.g.* Penny Lunt, *Lean and Mean is the Name of the Game*, ABA Banking Journal, March 1995, at 43; Peter Passell, *A Mystery Bankers Love: How Do Credit Cards Stay So Profitable?* The New York Times, August 17, 1995, at D2.

[5] Mannix reports that it is a growing practice in the industry for card issuers to dump cardholders who pay off their balance in full each month or who do not use their card enough. Some issuers have also eliminated the "grace period" for convenience users. Mannix, *supra*, November 27, 1995, at 88-89.

Because of this peculiar characteristic of the industry, card issuers aggressively encourage increased borrowing by cardholders, assuming the risks in pursuit of the profits.

One final trend that has resulted from the phenomenal growth in the use and prevalence of consumer credit cards, and the aggressive marketing by issuers, is that more consumers than ever before are encountering difficulty in meeting their minimum repayment obligations. The delinquency rate in 1990 was 27 percent higher than in 1985, a factor that cannot be attributed solely to recessionary forces. *See Global Growth of Credit Cards*, *supra*, at 54. Some experts have predicted that delinquencies will rise significantly in the next several years as consumers become unable to repay balances on the numerous cards pushed on them since in the early 1990's. *See* Holland & Melcher, *supra*, at 92. The New York Times reported in December, 1995, that the number of consumers seeking help from credit counselors in repaying credit card bills has reached record levels. Hansell, *supra*, The New York Times, December 28, 1995, at C1.

This increasing dominance of credit cards in the consumer economy, and its significant effect on consumers carrying ever higher levels of debt, demonstrates the importance of the states' ability to legislate against abuses and overreaching by the industry in the area of non-interest penalty fees.

B. The Credit Card Industry Is Dominated by Major Issuers Located in Small Deregulated States.

The enforcement of state consumer protection statutes is particularly important in light of the increasing concentration of major credit card issuers in a few small, deregulated states. Although there are more than 6000 issuers of credit cards in the United States industry, (*see* 1994 GAO Report, *supra*, at 2), the market is dominated by a relatively small number of mega-issuers. In fact, the ten largest issuers (measured by total outstandings) control more than 55 percent of the total market, and the top 25 issuers control more than 75 percent of the market. *See Card Industry Directory, supra*, 1993 ed., at 33, 66. Respondent Citibank, the single largest issuer in the country, is located in South Dakota. Six of the remaining top ten issuers, are located in Delaware.

South Dakota and Delaware, and a handful of other "deregulated" states, have undertaken a deliberate strategy to attract large credit card operations by creating an extremely favorable regulatory environment. *See Small States Teach a Big Banking Lesson*, Chicago Fed. Letter, June, 1986. In the early 1980's, these two states repealed consumer protection statutes that regulated consumer lending, passed laws favorable to banking interests, and undertook an aggressive campaign to entice credit card issuers to relocate from other states. *Id.* The strategy has been highly successful. *Id.* Unfortunately, the actions of the deregulated states have also had a significant detrimental impact on consumers residing in other states throughout the country. While the issue of exportation of penalty fees that is currently pending before this Court has remained unresolved, the major issuers located in deregulated states have routinely exported excessive penalty charges and other fees unregulated by their home state to consumers residing in other states. In 1993, late payment and overlimit penalty fees cost consumers throughout the country more than $1.9 billion. *See The Card Industry Rides a Wave of Profitability*, Credit Card News, April 1, 1994, at 2.

C. The Credit Card Industry Is Extraordinarily Profitable.

A 1995 publication characterized the credit card business as "about the most profitable in the financial industry," and reported that in 1994, the average credit card portfolio generated a 4 percent return on assets, a 60 basis point improvement since 1992. "A look at the most profitable *bank* credit card subsidiaries in 1994 shows ROAs [return on assets] as high as 11%, 7.7% and 6%." Lunt, *supra, Lean and Mean is the Name of the Game*, ABA Banking Journal, March 1995, at 43. (emphasis in original) In August, 1995, The *New York Times* reported that in 1994, eight of the top nine commercial banks, ranked by return on assets, specialized in credit card loans. Passell, *supra, A Mystery Bankers Love*, at D2. In 1993, the credit card industry earned more than $4.4 billion in after-tax profits, continuing a string of several years of annual profits in the $3.5-$4.5 billion range. *See The Card Industry Rides a Wave of Profitability, supra*, Credit Card News, April 1, 1994, at 1; *The Nilson Report*, November 14, 1991, at 1.

Credit card profits are extraordinary even in the banking industry. In a much-cited 1991 study and article, Lawrence M. Ausubel, then Professor of Economics at Northwestern University (currently Professor of

Economics at the University of Maryland), demonstrated that banks consistently earn profits on their credit card operations three to five times greater than the ordinary rate of return for the banking industry as a whole. *See* Ausubel, *supra, The Failure of Competition in the Credit Card Market*, at 50 (hereinafter "Ausubel, 1991").[6]

The 1994 GAO Report on the credit card industry not only confirms Ausubel's findings on the extraordinary profitability of the industry through the 1980's, but also documents that, after a very slight dip in 1991 at the height of the recession, the industry continued to earn very high profits through 1993. The Report notes that, between 1983 and 1990, Visa and Mastercard issuers' earnings averaged 4.68 percent of outstanding balances, a reliable measure of return on assets for credit card operations, while the overall earnings of banks in general averaged just .57 percent of assets. 1994 GAO Report, *supra*, at 19.

Although some aspects of Ausubel's analysis have been controversial, particularly his conclusions regarding the failure of the competitive model in the industry (addressed in the following section), the consistently supernormal profitability of the credit card industry has been confirmed in numerous publications over the past several years, and cannot be disputed. *See e.g.* Passell, *supra, A Mystery Bankers Love*, The New York Times, August 17, 1995, at D2; Lunt, *supra*, at 43; *Credit Card Rides a Wave of Profitability, supra*, at 1.

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[6] Ausubel recently reaffirmed these findings in *The Credit Card Market Revisited*, November, 1994 (unpublished paper), which was presented to the National Bureau of Economic Research in July, 1995 (hereinafter referred to as "Ausubel, 1994 Paper").

D. The Credit Card Industry is Extremely Resistant to Competition on Fundamental Pricing Terms.

A number of explanations have been offered for the high rate of profitability in the industry. It is clear, however, that one of the primary reasons is that, for the most part, the credit card industry has been extremely resistant to competition on long-term annual interest rates and other non-interest fees, including penalty charges. As a result, interest rates and other fees charged to consumer cardholders have remained very high even as the cost of funds for issuing banks has fluctuated over the years, and card issuers have amassed huge profits. In its 1994 Report on the industry, the GAO released statistics showing that, except for a slight dip in 1992 and 1993, average credit card interest rates have remained virtually constant at approximately eighteen percent for the past twenty years, with even higher rates charged by some major issuers.[7] During this same time, the interest rates at which issuing banks could borrow funds (a measure of lending costs) fluctuated regularly, plunging to between five and six

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[7] More recent data indicate that the slight drop in average interest rates in 1992 and 1993 was temporary, and that rates increased again in 1994. The *Wall Street Journal* reported in January, 1995 that "[i]nterest rates on credit card purchases now average about 17.7%, up from 16.65% last spring. With some economists expecting the Fed to raise rates again this year, '[t]he scenario is set for rates to actually exceed what they were in the 1980's.' " Nancy Ann Jeffrey, *Fees on Variable-Rate Credit Cards Rise*, Wall Street Journal, January 5, 1995, at C1, quoting Robert McKinley, President of RAM Research Corp., a Frederick, Maryland firm that tracks the bank card industry.

percent in the early 1990's. 1994 GAO Report, *supra*, Figure 1.2, at 16.

It has been documented that interest rates on credit cards have remained artificially elevated because issuing banks strenuously resist market competition on the basis of long-term interest rates or other significant pricing terms. Thus, although the industry likes to characterize itself as fiercely competitive, that competition focuses primarily on non-price terms, such as service, advertising, affinity programs, benefits, rebates, and other perks, and rarely reaches to the key pricing terms such as annual interest rates. *See* Ausubel, 1991, *supra*, at 53; Calem, *supra*, at 9.

Two recent industry trends appear, at least superficially, to indicate a slight break in this historical resistance to price competition. The first is the increase in the number of cards with variable rates; and the second is the recent "teaser rate" war among issuers. As late as 1991, only one-third of credit cards had a variable interest rate; today more than 70 percent of credit cards have variable rates. *See e.g.* Jeffrey, *supra*, at C1; Lunt, *supra*, at 43. When the variable rate cards were first issued, (largely in response to Congressional threats to impose caps on excessive credit card interest rates), they resulted in a decline in the "average most common interest rate" from 18.23% in 1991, to 17.76% in 1992, to 16.83% in 1993. *See* 1994 GAO Report, *supra*, at 15-18. In 1994 and 1995, however, these variable rates climbed again as the prime rate increased, bringing many consumers' rates back to the 18 to 20 percent range.

Similarly, in the past year, many card issuers have attempted to lure customers by offering an initial low

"teaser rate" that reverts to a much higher rate within a specified period, typically from three to six months. *See* Lunt, *supra*, at 45; Holland & Melcher, *supra*, at 92. *Amicus* Consumer Action regularly monitors developments in the credit card industry and publishes an annual survey of credit card terms. In its 1995 survey, the organization concluded that the prevalence of low teaser rates offered as bait to consumers is actually obscuring the considerable jump in average rates that occurred between 1994 and 1995. Linda Sherry, *High Rates Obscured by "Teaser" Come-ons*, Consumer Action News, March/April 1995, at 1. The survey also found that many of the teaser rates revert to "shockingly high" rates after the initial grace period. Thus, the variable-rate and teaser-rate trends in the industry represent nothing more than superficial competition and marketing strategies that have no significant impact on the long-term interest rates that consumers pay.

The significance of the industry's resistance to competition on interest rates is three-fold. First, it underscores the long-term profitability of the industry which is linked to the high interest rates issuers are able to maintain in the marketplace. Second, it highlights the fact that, for a variety of reasons unique to the industry, the exercise of consumer choice apparently has little effect on interest rates or other fees.[8] And third, the lack of competition on pricing terms is particularly applicable to non-interest penalty fees. Because most cardholders do not

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[8] For discussions of these barriers to competition in the marketplace, *see e.g.* Ausubel 1991, *supra*, 68-72; Ausubel 1994, *supra*, at 22-27; Calem, *supra*, 11-3; 1994 GAO Report, *supra*, 37-39.

intend, at the time they accept a card, to make late payments or to exceed their credit limit – minor breaches which, in most cases, result from either simple inattention or circumstances beyond the cardholder's control – *consumers do not choose a card based on the amount of penalty fees charged by the issuer.* As a result, there is no competitive incentive for issuers to charge lower penalty fees. Indeed, to do so would attract precisely the kind of cardholder they wish to avoid – the user who anticipates paying such fees at some point in the future.[9] As is discussed in the following section, this lack of market control has caused penalty fees to rise sharply in recent years, and further highlights the need for state regulation.

E. Lack of Regulation or Pricing Competition Has Led to Substantial Increases in Penalty Fees and Other Punitive Practices in Recent Years.

In the absence of regulatory and competitive restraints, and led by the banks located in deregulated states, card issuers have steadily increased their penalty fees in recent years. According to Consumer Action's 1995 Credit Card Survey, late fees are now almost universal among card issuers, whereas ten years ago, only about half of the card issuers charged a late or overlimit fee. *See* Stewart, *How Penalty Fees Are Rewarding Banks*, Credit

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[9] *See e.g.*, *Credit Card Conundrum*, *supra*, at 24 ("It may well be that the economics of price-cutting backfire in the credit card business. Companies choosing new customers with low rates simply lose profits . . . [because] the customers most likely to switch because of a rate cut are the riskier ones"). *See also* Ausubel, 1991, at 70; 1994 GAO Report, at 34.

Card Management, November 1991, at 39-40. Significantly, the size of the charges also has increased sharply in recent years. The average late fee for a regular Visa card shot up 22 percent, from $6.56 in 1987 to $8.03 in 1989, while the average overlimit charge at the end of 1989 was $11. *Id.* By 1995, the average late fee was up to $15, and most major banks were charging $18 or $20. Mannix, *supra*, *When Credit Turns Painful*, at 88.

Equally important, card issuers have begun imposing the fees more aggressively and in situations that appear patently unreasonable or unfair. According to a recent report:

> [Card issuers] used to give cardholders 10 days to get a payment in before slapping on a late fee. Now issuers will impose the fee any time the payment hasn't arrived by the due date – even if it's just one day late. . . . Issuers are also becoming less tolerant of trivial violations of the credit ceiling. If a cardholder went 10 or 20 percent over the credit line, the issuer used to look the other way. Now some issuers wallop cardholders who exceed the limit by a mere dollar.

Mannix, *supra*, at 88. The same article reported that card issuers are also beginning to engage in other punitive practices as a way of boosting profits. For example, many issuers now sharply increase a cardholder's interest rate if he or she makes only a single late payment, or otherwise "fails to meet the [undefined] requirements" of the card agreement. Other issuers have begun reviewing their cardholder's credit reports every six months. If an increase in "risk" is detected, which may be construed as nothing more than the act of applying for a car loan, the cardholder's interest rate is jacked up significantly, even

if the cardholder has an impeccable record with the issuer. *Id.* at 87-88.

Although issuers claim penalty fees are necessary to recover *costs* caused by delinquent borrowers, penalty fees are, in reality, a significant profit source. According to an industry publication, penalty fees "represent a significant revenue opportunity" that far exceeds any increased costs to issuers caused by late payments or overlimit charges.

> Some issuers argue they make the charges to cover extra costs incurred. But Auriemma Consulting Group Inc. looked at a broad range of nuisance fees – tariffs for card replacement and extra copies of statements as well as late payment, bounced checks and exceeding credit limits – and concluded they account for at least 60 basis points of the average bank card return on assets, up from around 30 points a few years ago.

See Stewart, *supra*, at 39-43.

It is well-known in the industry that the vast majority (75 percent or more) of consumers who miss a payment due date, make the payment before the next billing cycle. Thus, most consumers who are charged a late fee do not "default" in the sense that they fail to repay their debt. Rather, for any variety of reasons (e.g., extended vacation, sudden absence from home for family, work or medical reasons, temporary financial misfortune, etc.), these consumers simply fail to mail in a minimum payment by the due date. As such, for most of these consumers, the card issuer incurs little or no increased cost.

These consumers do not cause, and should not be saddled with, the card issuer's entire cost of defaulting cardholders, i.e. those cardholders who never repay their debt.[10] On the contrary, the risks and costs of default that are inherent in the credit card industry are reflected in the higher interest rates charged for unsecured borrowing; late payment and other penalty fees are essentially double-billing for the same risk.

While card issuers might reasonably impose a small late charge on cardholders for whom there is actually some form of increased collection activity as a result of a seriously delinquent payment or substantial over-credit-limit borrowing, the $18-$20 late fees and $20-$25 overlimit fees currently imposed by most major issuers bear no relationship whatsoever to actual costs associated with simple overdue payments or overlimit charges. The fees are fixed at an amount intended to deter and to punish minor breaches, while at the same time generating the greatest possible profit without triggering consumer

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[10] The importance of this distinction is demonstrated by Justice Mosk's erroneous contention in the decision below that, as a matter of public policy, "late payment fees may be employed to impose default costs on late payers, who are responsible for them, . . . " *Smiley, supra,* 11 Cal.4th at 161. While some late payers obviously do, in fact, default in repaying their debt, most commit only the minor offense of missing a single due date. If late payment fees are sanctioned as a legitimate attempt by issuers to recover the costs of defaulting cardholders, then cardholders who do nothing more than pay their bill a few days late are being unfairly allocated the costs of cardholders who never repay. Ultimately, however, the issue of whether credit card late fees are good or bad as a matter of public policy is an issue for state legislators; it is not an issue to be resolved by judicial expansion of section 85.

backlash. Such fees are entirely unrelated to the amount of the overdue payment or overlimit charge, the degree of delinquency, if any, or the cardholder's payment history.[11] Unless states are allowed to enforce consumer protections in this area, card issuers located in deregulated states will continue to export excessive, unnecessary, and even abusive penalty fees to consumers throughout the country.

II. THE COURT'S RESOLUTION OF THE IMPORTANT PREEMPTION ISSUE IN THIS CASE COULD HAVE SIGNIFICANT IMPACT ON STATE CONSUMER PROTECTION EFFORTS.

A. Federal Preemption of State Consumer Protection Statutes Should Be Narrowly Construed.

It is well-established that consumer protection is one of the "historic police powers of the States." *See e.g. California v. ARC America Corp.*, 490 U.S. 93, 101 (1989);

[11] Consumer litigation filed against banks in California has confirmed that the penalty fees imposed by card issuers are generally far in excess of any increased costs incurred as the result of late payments or other cardholder breaches. In *Beasley v. Wells Fargo Bank, N.A.*, 235 Cal.App.3d 1383, 1 Cal.Rptr.2d 446, *rev. denied* (1991), a jury awarded, and the Court of Appeal affirmed, $5.2 million in refunds for late and overlimit fees the bank had collected in excess of its actual damages resulting from breach. In a separate action against First Interstate Bank of California, tried in 1992, the class recovered approximately $5 million in excess fees. *See Hitz v. First Interstate Bank of California*, 38 Cal.App.4th 274, 44 Cal.Rptr.2d 890, *rev. denied* (1995). Moreover, the $3 to $5 late fees and $10 overlimit fees proven excessive in these actions were significantly lower than the $18-$20 late and overlimit fees currently charged by most major issuers.

Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 38 (1980); *Perdue v. Crocker National Bank*, 38 Cal.3d 913, 216 Cal.Rptr. 345, 702 P.2d 503, 520 (Cal. 1985), *appeal dismissed*, 475 U.S. 1001 (1986). It also has long been recognized, and reaffirmed by this Court on numerous occasions, that states have the power to regulate banking practices, including the practices of nationally-chartered and interstate banks, for the protection of consumers or other purposes. *See Lewis v. BT Investment Managers, supra*, 447 U.S. at 38 ("both as a matter of history and as a matter of present reality, banking and related financial activities are of profound local concern"); *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 248 (1944) ("[n]ational banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions."). *See also Perdue v. Crocker National Bank, supra*, 702 P.2d at 520-21 (national banks are subject to both federal and state regulation, and are generally governed more by state law than by federal law in their day to day operations, except when there is an express conflict).

Thus, it is clear that states have the power to regulate the activities of national banks for the protection of consumers. As such, this Court has repeatedly emphasized that *" 'the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress.' "* *See Cippollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992), (emphasis added) and cases cited therein. Accordingly, preemption provisions must be construed narrowly "in light of the presumption against the preemption of state police power regulations. This presumption reinforces the appropriateness of a narrow reading of [the express preemption provision]." *Id.* at 518.

In this action, the court below essentially disregarded this fundamental principle of limited federal preemption, paying lip service to the applicable authorities, but then engaging in precisely the kind of broad construction and implied preemption analysis that is specifically prohibited. This fatal flaw in the majority's decision was emphasized by Justice Arabian in his dissent, in which he observed that the majority adopted an "expansive definition" of interest, "not because of any evidence that Congress *actually* had such an idea in mind when it enacted the National Bank Act, but because of the majority's own theory about the state of American banking at the time." *Smiley v. Citibank, supra*, 11 Cal.4th at 166 (Arabian Dissent) (emphasis in original). Justice Arabian went on to demonstrate not only that the majority's expansive interpretation of the term "interest" was insupportable as both a matter of law and history, but also that the majority's entire theory about the purpose of the National Bank Act was incorrect and based on historical inaccuracies. *Id.*, 11 Cal.4th at 167-172. Chastising the majority for abandoning the concept of limited federal preemption, Justice Arabian quoted from another court that rejected preemption under the same circumstances: " 'a proposition that is not obvious from the plain meaning of a statute's language, nor from its legislative history, simply cannot be regarded as a clear manifestation of congressional intent." *Id.* at 4, *quoting Copeland v. MBNA America, N.A., supra*, 820 F.Supp. at 541.[12]

[12] Under the applicable authorities of this Court, as acknowledged by Justice Arabian in his dissent, if statutory language is unclear, the interpretation must be narrow and the construction limited, such that any aspect of preemption not specifically included must be rejected. The majority below did exactly the opposite. It conceded that the statute was unclear, but then interpreted it expansively, finding that the statute preempted late charges not because they were specifically included in section 85, but because they were not specifically excluded.

B. A Finding of Broad Preemption in this Case Could Hinder Consumer Protection Efforts in Other Important Areas.

If this Court affirms the broad preemption analysis of the majority below, the ruling could have a significant negative impact on state consumer protection legislation in the consumer banking area. The preemption issue in this case is not simply about the *amount* of late payment and overlimit fees that may be exported by national credit card banks located in deregulated states; it is also about the *manner and circumstances* under which the fees may be imposed, and whether other non-interest rate fees and practices may be regulated by the states. In the absence of regulation in their home states, many issuers now impose a substantial late fee even if a cardholder's payment is only one day late, through no fault of the consumer. Others repeatedly increase the cardholders' credit limits, *approve overlimit charges at the point of sale*, and then hit consumers with a $20 overlimit fee even if they exceed their limit by only a few dollars. California and a number of other states have found these practices, as well as the amount of the penalty fees, to be unfair to consumers, and have chosen to enact protections. These state consumer protection efforts should not be blocked by other states' cynical re-definitions of the term "interest." Moreover, if this Court interprets section 85 broadly, declaring late payment fees to be "interest," credit card

issuers located in deregulated states are likely to assert that any number of other fees and charges, including annual fees, returned check fees, collection costs, and attorneys' fees, are also "interest" exempt from any state consumer protection regulation.

This Court's decision is also likely to have a significant impact in other areas in which states' attempts to regulate consumer banking practices may encounter claims of federal preemption. For example, there is likely to be spillover effect in the area of state "lifeline" banking laws. Increasing bank fees for checking accounts have priced many lower income consumers out of the federally-insured banking system. In the absence of national legislation requiring banks to offer low-cost checking accounts to consumers, several states have considered state "lifeline" laws. New Jersey passed such a law in 1991; New York followed in 1994. Maryland currently has such legislation under consideration. *Amicus* Consumer Action endorses these state legislative efforts on behalf of low-income consumers.

In 1992, however, the Office of the Comptroller of the Currency (OCC) issued a determination asserting that New Jersey's Consumer Checking Account Act was preempted by federal banking statutes, specifically the 1991 Bank Enterprise Act, which had established a system for supporting voluntary "lifeline" accounts, but did not require national banks to provide such accounts. There was considerable opposition to the OCC's determination. As a result, the OCC recently issued a new Federal Register Notice, 61 Fed.Reg. 4515 (February 6, 1996), seeking comment on the request of the New Jersey Department of

Banking that the preemption determination be re-considered. The OCC's tentative decision is to reverse its earlier preemption determination.

Although there are differences between the credit card late fee issue in this case and the "lifeline" checking account issue, both raise the same important concern – whether federal banking statutes that evidence no intent by Congress to occupy the field of consumer banking nevertheless may be interpreted broadly to preempt state consumer protection statutes as applied to national banks.

Another area in which this Court's determination on the preemptive scope of section 85 is likely to have an effect is in state regulation of a whole new panoply of fees that banks are beginning to charge for services that were traditionally provided without charge, or that are attached to new technological services, including computer on-line banking fees, ATM surcharges, interlink fees, "human teller" fees, research and copying fees, bounced check fees, and fees for any number of non-banking services and products. A finding of broad preemption under section 85 might also lead national banks to assert preemption when states attempt to regulate non-fee practices, including advertising, lending practices, and debt collection practices. Consumer Action is concerned that its efforts to advocate against excessive fees, and other unfair practices in the area of credit cards and consumer banking not be stymied by specious claims of federal preemption, particularly when the practice at issue is not subject to any federal control or regulation.

C. A Finding of Broad Preemption in this Case Will Create Pressure on Other States to Deregulate.

Finally, it is important to note that a ruling from this Court that credit card late fees may be "exported" pursuant to section 85 from deregulated states will create substantial pressure on other states throughout the country to deregulate as well. If the dominant banks located in deregulated states are exempt from other states' consumer protection statutes, even when soliciting and profiting from consumers in those states, and are allowed to export not only interest rates, but also substantial penalty fees and any number of other non-interest rate charges and terms, local banks in states with consumer protections may be placed at a competitive disadvantage.[13] Claiming such a disadvantage, card issuers around the country have threatened to leave states that limit or prohibit penalty charges and move to nearby deregulated states. In order to retain these local banks, and the associated jobs and revenues, many state legislatures have been forced to consider the repeal of consumer protection statutes limiting late charges and other non-interest fees.[14]

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[13] Note that enforcement of state statutes against out-of-state national banks does not result in *discrimination* against national banks, but merely makes them subject to the same restrictions that are applicable to *all* banks that solicit consumers in the state.

[14] *See Small States Teach a Big Banking Lesson*, Chicago Fed. Letter, *supra*; *Group Advocates State Regulation of Credit Cards*, American Banker, p. 3 (July 29, 1987); *Mad As Hell About Late Fees*, Business Week, (February 24, 1992), at 32; *Legal Issues: It's Win One, Lose One for Card Lobbyists in 1994*, Credit Card News, (February 1, 1994); *You Win Some, You Win Some More*, Credit Card Management, (February 1994), at 60-62.

An industry publication noted in February, 1994, that "[t]he industry has done well in winning relaxed limits on, and out-right deregulation of, credit card fees, particularly late fees. Virginia and New York lifted restrictions in 1992, and several states followed suit last year, including Idaho, Illinois, Massachusetts, West Virginia and Michigan." *See* Higgins, *You Win Some, You Win Some More*, Credit Card Management, February 1994, at 60. The pattern was repeated last year in California when a jobs-versus-consumers debate ultimately resulted in the enactment of a new statute allowing higher late charges and overlimit fees in credit card contracts under certain specified conditions.

In contrast, if this Court finds that section 85 is limited to its express intent to limit interest rates, state consumer protection statutes regulating penalty charges will apply equally to both local and out-of-state banks, whether national or state-chartered, such that no bank is placed at a competitive disadvantage.

It may well be that it is in the interest of consumers throughout the country to have a nationwide standard of allowable non-interest rate terms for consumer credit card customers, including late payment fees. If that is to be the case, however, it is an issue to be addressed by Congress, after the serious research and debate the issue warrants, and with due consideration for the interests of consumers. In the absence of such action by Congress, deregulated states such as South Dakota and Delaware which have chosen to subordinate consumer interests to banking revenues, should not be allowed to make this same choice for other states, and, in effect, to deregulate the consumer credit card industry for consumers nationwide.

CONCLUSION

Accordingly, for the foregoing reasons, *amicus* Consumer Action urges this Court to reverse the decision of the court below.

Dated: March 1, 1996

Respectfully Submitted,

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(8)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

vs.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ of Certiorari to the California Supreme Court

BRIEF OF AMICUS CURIAE BANKCARD HOLDERS OF AMERICA IN SUPPORT OF PETITIONER

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PARTIES' CONSENT FOR FILING THIS BRIEF AS AMICUS CURIAE

Both petitioner and respondent have consented to the filing of this brief pursuant to Rule 37(3)(a).

AMICUS' INTEREST AND SUMMARY OF ARGUMENT

Bankcard Holders of America ("Bankcard") submits this brief in support of petitioner Barbara Smiley.

Bankcard is a national, non-profit organization dedicated to consumer credit education and advocacy. Founded in 1980, Bankcard has a current membership of more than 25,000 individual consumers. Bankcard receives no financial support from the banking or credit industry. Instead, it relies on membership dues, charitable donations and publication sales. In addition to its bi-monthly newsletter reporting on credit industry practices and credit card opportunities, the organization has published and distributed educational pamphlets for credit card consumers such as "Consumer Credit Rights" and "Credit Cards: What You Don't Know Can Cost You!"[1]

Bankcard submits this brief because it believes that section

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1. Bankcard's counsel are well acquainted with the legal issues in this case because of their representation of the plaintiffs in a pending class action filed in California state court that challenges the late fees charged by Greenwood Trust, the issuer of the "Discovercard." (*Cynthia St. John, et al. v. Greenwood Trust*, County of Alameda, Case No. 695111-5). Although the *St. John* complaint successfully withstood a federal preemption challenge under § 521 of DIDA, the action has been stayed by stipulation pending this Court's expected resolution of the preemption issue. The *St. John* plaintiffs participated as amici curiae on behalf of petitioner Smiley when this case was before the California Supreme Court.

85 of the National Bank Act, 12 U.S.C. § 85, and section 521 of the Federal Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), 12 U.S.C. § 1831d(a), are being used to eradicate volumes of state laws that have protected credit card holders from overreaching by large financial institutions. These state laws, both common law and statutory, prevent banks from exacting unbargained-for penalties from cardholders that far exceed the losses that the banks have suffered as a result of the cardholders' breaching the contracts by making late credit card payments. These state laws reflect the states' exercise of their historical power to protect their citizens from unlawful *penalties.* They do not purport to regulate the "interest" terms of the cardholder contract that set the price that banks charge for the credit that they sell to cardholders.

The central legal issue in this case is whether the Civil War Congress intended the term *rate of interest* in § 85 to refer to a liquidated penalty for a late loan payment. Bankcard's brief offers the Court two different perspectives on this issue. Part II of this brief discusses the historical meaning of the term interest in both common usage and the early legal precedents that set the stage for § 85 and construed the statute after its enactment. Although the historical evidence is not conclusive, it furnishes persuasive proof that the Congress of 1864 only undertook to create a preemptive shield against discriminatory state usury laws that placed national banks at a competitive disadvantage in terms of the price they could charge for the use of their money.

This historical view of § 85 comports with the internal logic of the statute. Section 85 allows a national bank to charge the higher of two *rates*: the rate of interest allowed by the law of its home state or an adjusted Federal Reserve Bank discount rate. An interpretation that defines "interest" as including liquidated penalties is unworkable because it is impossible to compare either the home state's usury rate or the adjusted federal discount

rate with the unpredictable late charges that are contingent on future breaches of the loan contract.

Part III approaches the same issue by examining § 85's modern descendent, § 521 of DIDA. Section 521, which was enacted in 1980, was unquestionably designed to extend the same protection that national banks have under section 85 to state chartered banks. Because the legislative history of § 521 is understandably more extensive than the limited record concerning § 85, the congressional intent behind § 521 offers an invaluable insight into the meaning of the earlier statute on which it was modelled. This modern legislative development confirms that both §§ 85 and 521 were enacted to create a level playing field of usury limitations on the prices that national and state banks charge for the use of their money in the credit marketplace. These federal statutes have no bearing on the states' traditional power to regulate liquidated penalties, fraudulent offers of get-a-way vacation packages to promote credit card sales, and other non-price aspects of the bank-cardholder relationship.

ARGUMENT

I.

THE WORDS "INTEREST AT THE RATE" IN 12 U.S.C. § 85 DO NOT INCLUDE CONTINGENT PENALTY FEES SO AS TO PREEMPT CALIFORNIA LAW.

A. The Historical And Common Definition of "Interest" Excludes Penalty Charges.

The California Supreme Court applied an expansive definition of interest that is at odds with the ordinary meaning of the term that arose long before the passage of the National Bank Act and has persisted ever since. Contemporaneous 19th

Century dictionaries suggest that "interest" was not understood at that time to include late fees or other penalty charges; rather, interest was limited to a periodic rate. *See* Wharton's Law Lexicon 391 (2d ed. 1860) ("Interest, the sum of money paid or allowed for the loan or use of some other sum, lent for a certain time, according to a fixed rate"); Bouvier's Law Dictionary 652 (4th ed. 1852) ("Interest for money, contracts: The compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use").

These definitions make it quite likely that the 38th Congress understood that the word "interest" pertains to the time-value of money. Interest is contra-distinguished by the sum-certain late fees or "penalty fees" imposed by the respondent here in that the latter are not compensation for the use or forbearance of money, but instead are punishment charges beyond the time-value of money which are in addition to the continuing finance charges imposed.

B. Federal Common Law Requires A Time-Based Measure Of Interest.

There is no indication that Congress intended "interest" in § 85 to be different from the common law meaning of the term. Further consideration of the historical context beyond dictionaries demonstrates that Congress and the common law have always considered "interest" to be measured by time.

On at least two occasions before passage of the National Bank Act in 1864, this Court held that contingent default charges, like late fees, were not "interest." *See Lloyd v. Scott*, 29 U.S. (9 Pet.) 205 (1830) and *Spain v. Hamilton's Administrator*, 68 U.S. (1 Wall.) 604, 626 (1863).

Thus, the federal common law had established a definition of the term "interest" even before the National Bank Act was

passed. All contingent loan charges that were specific sums not measured by time and which could be avoided by the borrower were considered to be penalties, not "interest." *Lloyd*, 29 U.S. at 226. The established common law, therefore, distinguished between time-based interest charges and contractual penalties within the borrower's control. The latter were not considered "interest."[2] *See Hahn v. Hank's Ambulance Service, Inc.*, 787 F.2d 543, 544 (11th Cir. 1986) (late charges are different from interest rate finance charges). Since Congress is presumed to have adopted the federal common law meaning of "interest" in enacting § 85, that statute cannot be construed to encompass contractual penalty charges within the borrower's control, such as the fees assessed by the respondent.

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2. This distinction has continued to the present. In the Truth-In-Lending Act, 15 U.S.C. §§ 1601, *et seq.* ("TILA"), Congress defined "finance charges" (a term including "interest") to *exclude* "delinquency charges." In *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257 (3d Cir. 1975), the Third Circuit recognized that there was a difference between the two terms, "finance charges" and "delinquency charges," and that historically Congress was well aware of the difference:

> [P]rior to enactment of the [TILA], the terms "default charges" and "delinquency charges" had well established meanings in the commercial credit field and in other consumer credit legislation, *and it is certain that Congress was well aware of these definitions.* In the commercial credit field and in other consumer credit legislation, the terms "delinquency charges" and "default charges" generally refer to specific pecuniary sums that are assessed against the borrower solely because of his failure to make his payments in a timely manner. They are sums above and beyond the amount ordinarily due in the event of timely payment.

Id. at 265-66.

Indeed, the common understanding around the passage of the National Bank Act distinguished "interest" from post-loan "penalty" charges. *See Mazaika v. Bank One, Columbus, N.A,* 439 Pa. Super. 95, 653 A.2d at 654-56 (Cirillo, J., concurring), *alloc. granted,* 659 A.2d 557 (Pa. May 25, 1995). In the first case addressing the issue after the National Bank Act was passed, a United States Circuit Court affirmed a district court holding that a provision in a note imposing collection costs after a loan default was "a stipulation for a penalty or forfeiture [under common law] . . . and void." *Merchants' Nat'l Bank v. Sevier,* 14 F. 662, 663 (C.C. E.D. Ark. 1882).

In *Merchants',* the district judge, with whom the Circuit Court fully agreed, directly considered the power of national banks to impose post-default collection costs. Relying on this Court's decision in *National Bank v. Johnson,* 104 U.S. 271 (1881), the court rejected the argument that a national bank could charge collection costs as "interest." 14 F. at 665.

Consistent with that precedent, the court reasoned that rates charged by national banks were limited to the standard commercial usage and practice of banks. *Id.* Because stipulations for collection costs after a loan default were "contrary to the usage and practice of banks," the bank could only recover the principal and interest on the loan, not the contractual penalty. *Id.* at 667.

Merchants' also demonstrates that Congress could not have intended "interest" to include contractual penalties. Late charges had always been and continue to be considered distinct from interest. *See Lloyd v. Scott,* 29 U.S. (9 Pet.) 205 (1830); *Spain v. Hamilton's Administrator,* 68 U.S. (1 Wall.) 604, 626 (1863); *United States v. Texas,* 113 S. Ct. 1631, 1634-36 (1993); *Garrett v. Coast & So. Fed. S&L Ass'n,* 9 Cal. 3d 731, 511 P.2d 1197 (1973). Where, as with late charges, the borrower could

avoid the additional charge by paying on time, the common law treated the charge as a contractual penalty, *i.e., nomine poenae* or *interesse poenae,* that was outside the scope of the usury statutes. *See, e.g., Lloyd,* 29 U.S. at 226; *Ramsey v. Morrison,* 39 N.J.L. 591, 593 (1877).

As in *Lloyd v. Scott,* respondent's penalty charges represent specific sums which may be avoided by a punctual payment. Unlike the respondent's time-based interest charges, the fees are not compensation for a loan of money. Instead, they are "penalties" for an avoidable contractual breach. Thus, respondent's default charges are not "interest" within the common law meaning of that term as it was used by Congress in the National Bank Act.

C. Respondent's Interpretation of § 85 Defies the Rate Comparison Required By the Statute.

The argument that "interest" in § 85 means "all charges" conflicts with this Court's holdings in *National Bank v. Johnson,* 104 U.S. at 277 ("The sole particular in which national banks are placed on an equality with natural persons is as to the rate of interest, and not as to the character of contracts they are authorized to make") and *Evans v. National Bank,* 251 U.S. 108, 111 (1919) ("[The National Bank Act] adopts usury laws of the States only in so far as they severally fix the rate of interest"). In those cases, the Court ruled that § 85 refers to state law only for the "*rate*" and not for the character of the contracts signed by national banks. Late fees obviously cannot be measured by a "rate" because they only occur after a payment has been missed and are unrelated either to the amount of the payment or the amount of the outstanding balance. To define "interest" as all lending charges is to read the word "rate" right out the statute.

A definition of "interest" that includes "all charges" is

logically flawed because it would place hundreds of national banks in an untenable position. In the vast majority of states that have precise interest rate limits, national banks could not be certain of their compliance with § 85 because some of the lending charges would be within the borrower's control. A bank could not possibly know whether the ultimate interest rate on any given loan would exceed the home state's usury ceiling, because a borrower could always render the loan unlawful simply by incurring late charges.

The decision below creates the same quandary with respect to the alternative *rate* ceiling that is pegged to the adjusted Federal Reserve discount rate. *See* 12 U.S.C. § 85.[3] That the lawfulness of a national bank's interest charges is determined by a comparison to this federal discount *rate* is further evidence that Congress did not intend the term "interest" to be construed to include penalty charges. *Cf. Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) (an important statutory term should be construed consistently with the other terms with which it is associated).

Section 85 permits national banks to charge interest as measured either by the maximum interest rate established in the state where the bank is located or 1% more than the discount rate on 90-day commercial paper charged by the Federal Reserve Bank where the bank is located, whichever is greater. Although "discount" interest is usually paid up front, and "loan" interest is usually paid periodically during the loan term, the elements of the two terms are identical, and interest on a "loan" or on a "discount" must be calculated the same way. *See Nat'l Bank v.*

3. The alternative discount rate measurement was first added to § 85 by a 1933 amendment. *See* Banking Act of 1933, Ch. 89, § 25, 48 Stat. 162, 191. The term "discount rate" has roots extending back to at least the 1700's when it was common practice for the Bank of England to extend loans to the Crown by way of discounting notes or bonds issued by the British government.

Johnson, 104 U.S. at 277 (loans and discounts are "synonyms" and are subject to the same *rate* of interest). The term "discount rate" means a rate *per period of time* for loans or discounts on commercial paper. *See, e.g., Evans v. Nat'l Bank*, 251 U.S. at 114; Brekenridge, *Discount Rates in the United States*, 13 Pol. Sci. Q. 119, 120-22 (Table) (1898) ("*Discount Rates*"), *cited with approval in Marquette*, 439 U.S. at 317.

If "interest" included liquidated late payment penalties, a national bank would be unable to determine whether its "interest" charges complied with the federal discount *rate* ceiling. Rather, a bank's compliance with § 85 would depend on contingent future breaches which it could not predict when the loan contract was made. Thus, the *rate* comparison that is a core component of the statute logically confirms that Congress believed that interest — whether determined by the maximum rate allowed by the home state's usury law or the alternative maximum, adjusted federal discount rate — should be measured over time to compensate the lender for the use of its money.

II.

CONGRESS' INTENT IN CRAFTING § 521'S LIMITED PREEMPTION PROVISION IS PERSUASIVE EVIDENCE THAT THE PREEMPTIVE REACH OF § 85 OF THE NATIONAL BANK ACT IS SIMILARLY LIMITED.

Because Congress intended that § 521 complement § 85, Congress' view of the meaning of § 521 is strong evidence of Congress' understanding of the meaning of § 85. Although "a later Congress' understanding of the legislative intent of an earlier Congress is not binding on the courts, it is entitled to deference." *United States v. Stewart*, 779 F.2d 538, 540 (9th Cir. 1985), *cert. denied*, 484 U.S. 867 (1987). *See also Bell v. New*

Jersey, 461 U.S. 773, 784 (1982) (view of later Congress has persuasive value in determining intent of earlier Congress). Moreover, where, as here, the precise intent of the enacting Congress is obscure, the views of a later Congress regarding that intent "are entitled to significant weight." *Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596 (1980). Because § 521's preemptive reach is limited to the usury ceilings imposed by state constitutions and statutes, it is difficult to accept a strained interpretation of § 85 that eradicates common law remedies against unconscionable late payment penalties.

A. Section 521 Must Be Construed As Preempting Only State Usury Ceilings.

In its decision below, the California Supreme Court joined a number of other state and federal courts that have followed the holding and reasoning of the federal First Circuit Court of Appeal's decision in *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir.), *cert. denied*, 506 U.S. 1052, 113 S. Ct. 974 (1992) (hereinafter "*Greenwood/Mass.*") In *Greenwood/ Mass.*, the court considered a Massachusetts statute that barred late payment penalties. The court held that this statute was expressly preempted by § 521 of DIDA.

The decisions that have followed the lead of *Greenwood/ Mass.* overlook the fact that § 521 preempts only state *constitutional* or *statutory* limits on the *rate* of interest which state chartered banks can charge. The express terms of § 521's preemption clause confirm that the clause does not reach claims that are based on common law rights. Section 521 states in pertinent part:

> State chartered insured banks . . . may, notwithstanding any State *constitution* or *statute* which is hereby preempted for the purposes of this section, take, receive . . . *interest at a rate* of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank . . . or *at the rate* allowed by the laws of the State . . . where the bank is located, whichever may be greater.

(Emphasis added).

Section 521 takes precise aim at state constitutions and statutes because state usury limits have always been creatures of statutes or constitutions. As long ago as 1888, the California Supreme Court observed that "[t]he illegality of usury is wholly the creature of legislation. . . ." *Coleman v. Commins*, 77 Cal. 548, 554 (1888). Professor Ackerman likewise explains that:

> [i]n the United States, the tradition of *statutory* limitations on interest rates dates back to Colonial times. Forty-six states still retain rate ceilings. American usury laws were modeled on the Statute of Anne (1713), itself derived from still earlier legislation and debate."

J.M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 Ariz. St. L.J. 61, 62 (emphasis added).

Petitioner Smiley's theories of liability are not based on legislative or constitutional usury ceilings. For example, although Ms. Smiley's complaint refers to the codified version of the liquidated damages rule in § 1671, Cal. Civ. Code, she may also elect to pursue the common law remedy for unlawful liquidated damages. *See Rojo v. Kliger*, 52 Cal. 3d 65, 79, 276

Cal. Rptr. 130 (1990) (plaintiff may elect to pursue common law remedy even when statutory remedy exists). A claim that a late charge constitutes unlawful liquidated damages is a common law claim. Indeed, a California Court of Appeal recently held in a class action challenge to a credit card late payment fee that the original codification of the liquidated damages rule "did not create new law but simply codified the existing common law." *Beasley v. Wells Fargo Bank*, 235 Cal. App. 3d 1383, 1398, 1 Cal. Rptr. 2d 446 (1992). Moreover, although § 1671 was amended in 1977 to include new rules regarding liquidated damages in non-consumer contexts, the *Beasley* court held that the 1977 statute nevertheless "retain[ed] the former codified common law rule for consumer actions [¶1671(d)]." *Id.* at 1399.

Because Congress only intended to afford state banks parity of treatment with respect to state *usury* limits, the modern Congress correctly confined § 521's preemptive effect to state *constitutions* and *statutes*. Because petitioner's challenge is anchored in a common law, non-usury remedy, her action would not be preempted if directed at a state bank. The same conclusion must apply to her claims against a national bank because § 521 draws its meaning from § 85. *Greenwood/Mass., supra*, 971 F.2d at 826-27.

B. In Deference To Reserved State Powers, § 521's Express Preemption Provision Must Be Construed As Not Preempting Common Law Claims.

In *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S. Ct. 2608 (1992), this Court rejected an attempt to construe an express preemption provision which referred, at best, to statutory enactments, as also embracing common law claims.[4]

4. Although a statute can either expressly or impliedly preempt state law, § 521 of DIDA is an *express* preemption statute. When, as in § 521, (Cont'd)

Cipollone is highly relevant to the issue before this Court: *viz:* whether the express preemption provision contained in section 521 of DIDA also extends to common law claims.

In *Cipollone*, this Court looked at a preemption statute contained in the Federal Cigarette Labelling and Advertising Act, Pub. L. 89-92, 79 Stat. 282, as amended, 15 U.S.C. §§ 1331-1336 (the "1965 Act") and a later version of that provision contained in the Public Health Cigarette Smoking Act of 1969, Pub. L. 91-222, 84 Stat. 87, as amended, 15 U.S.C. §§ 1331-1340 (the "1969 Act"). The preemption provision in the 1965 Act read as follows:

> (a) No statement relating to smoking and health [other than a federally approved statement] . . ., shall be required on any cigarette package, . . . (b) No [such statement . . . shall be required in the advertising of any cigarettes the packages of which are labeled in conformity with [federal law].

Cipollone, 505 U.S. at 534 (quoting 1965 Act). The tobacco companies argued that this provision preempted common law claims which would have imposed liability on them for failing to provide sufficient warnings to smokers about the hazards of cigarette smoking.

This Court disagreed. The Court held that the statute's

(Cont'd)
Congress has expressly addressed the issue of preemption, there ordinarily is no cause to look beyond the express language of the preemption statute. *Cipollone*, 505 U.S. at 517 [112 S.Ct. at 2618]. Even the First Circuit in *Greenwood/Mass.* eschewed implied preemption analysis because it acknowledged that § 521 contains an express preemption provision. 971 F.2d at 823.

reference to positive "requirements" could only be read as referring to *statutory* enactments and therefore refused to read the statute as preempting common law claims. *Id.* at 518-519. The *Cipollone* Court began its analysis of the scope of this provision by affirming that a state's " 'historic police powers [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress.' " *Id.* at 516, quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The Court held that preemption provisions must be construed:

> in light of the presumption *against* the preemption of state police power regulations. This presumption reinforces the appropriateness of a narrow reading of [the express preemption provision].

Id. at 518.

It is important to note that under its express preemption analysis, this Court read the 1965 Act "narrowly." In so doing, this Court concluded that the language preempting state-imposed "requirements" could only be construed as preempting "positive enactments by *legislatures* or administrative agencies that mandate particular warning labels." *Id.* at 519 [emphasis added]. Thus, because the preemption provision referred, at best, *only* to statutory enactments, it could not be read as eradicating common law remedies. *Id.*

Section 521 is a far simpler statute to construe than the 1965 Act that confronted the *Cipollone* Court. In *Cipollone*, the Court had to determine whether the term "required" referred only to legislation or was broad enough to include common law claims. Guided by the principle that an express preemption provision must be read narrowly, the Court ruled that the term "required" must be limited to legislative enactments. Here, because § 521

refers explicitly *only* to "State *constitution[s]* or *statute[s]*," it is absolutely clear that state common law claims do not fall within the express preemption language of § 521.

The *Cipollone* Court also looked at a later version of the express preemption provision contained in the 1969 Act, and a plurality of the court held that this provision *did* preempt common law claims. The court's discussion of this provision is, therefore, instructive in determining the sort of language Congress must use before a court may hold that a common law claim is expressly preempted.

The 1969 Act contained a preemption provision that read as follows:

> No requirement or prohibition based on smoking and health shall be imposed *under State law* with respect to the advertising or promotion of any cigarettes the packages of which are [lawfully labelled under federal law].

Cipollone, 505 U.S. at 515 (emphasis added). Four justices concluded that the broad reference to "State law" contained in the 1969 Act did encompass state common law as well as state statutes. *Id.* at 523 (plurality opinion). Another three justices vigorously disagreed with this reading of the phrase "State law" because they still were not satisfied that this language was sufficiently explicit so as to include state common law claims. *Id.* at 538-539 (Blackmun, J., concurring in part and dissenting in part). It is quite clear, however, that all seven justices concluded that a state's common law will not be preempted unless the language of the preemption statute expressly states Congress' intention to do so.

It is also clear that § 521 of DIDA cannot be construed as preempting common law remedies because Congress explicitly chose to limit its preemptive reach to state constitutions and statutes, that is, to state usury laws. In holding that the 1969 Act's preemption provision embraced common law rights, the *Cipollone* plurality emphasized that the term "state law" replaced the terms "any state *statute or regulation*" [original emphasis] which appeared in an earlier version of the bill which was originally enacted. By contrast, § 521 uses essentially the same words which the *Cipollone* majority equated with an intention *not* to preempt common law. Under *Cipollone*, therefore, section 521, and by extension, § 85, cannot be read to include any of petitioner Smiley's claims because these claims are grounded in California common law.

C. DIDA's Legislative History Confirms That Congress Deliberately Limited Section 521's Preemptive Scope To State Usury Ceilings.

As explained above, the express language of § 521 defeats the banks' contention that the statute shields their campaign to destroy the traditional common law protections against unconscionable liquidated penalties. Any venture into the purpose and effects of preemption constitutes an *implied* preemption analysis that has marginal relevance to an *express* preemption provision. Nevertheless, the Court need not look far to find ample evidence that Congress quite deliberately chose not to tamper with a state's traditional power to protect its citizens from excessive liquidated penalties.

1. Background Of Part V Of DIDA: The 1970s' Credit Crunch

In the 1970's, the United States economy experienced a period of severe inflation and recession which caused a dramatic

rise in interest rates. The federally chartered banks easily weathered this storm because § 85 allowed their lending rates to rise with the inflation sensitive federal discount rate. By contrast, the state chartered lenders were trapped in an ever tightening vise between the higher interest rates they had to pay to procure money and the relatively low usury ceilings imposed by their state constitutions or statutes.[5] This credit crunch, which placed state lenders at an extreme competitive disadvantage vis-a-vis federally chartered lenders, set the stage for DIDA. *E.g.*, S. Rep. No. 368, 96th Cong., 1st Sess. 18 (1979), *reprinted in* 1980 U.S.C.C.A.N. 236, 254.

2. DIDA's Broadest Provision, Section 501, Excludes Late Charges.

The first provision of Title V of DIDA, and the first to be considered by Congress, is section 501. With respect to home mortgage loans, § 501(a)(1), 12 U.S.C. §1735f-7a, expressly preempts:

> The provisions of the constitution or the laws[6] of any State expressly limiting *the rate or amount of interest, discount points, finance charges, or other charges which may be charged. . . .*

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5. Insofar as a state chartered lender depended on time deposits, this source of lending capital quickly dried up as depositors turned to money market accounts and other sources of interest income that were not hampered by usury limits.

6. Section 501(a)(1)'s use of the term "laws" as a preemption defining term was not intended to encompass state common law rules. In explaining the purpose of § 501(a)(1), the Senate Banking Committee report declared that the provision "would preempt any State *constitutional or statutory* provision setting a limit on mortgage interest rates." S. Rep. 96-368, *supra*, at 18, 1980 U.S.C.C.A.N. at 254.

Unlike § 521 and other provisions of Title V, § 501(a)(1) draws a distinction between "the rate or amount of interest" on the one hand and both specified and unspecified "other charges" on the other.[7] In explaining the meaning of this provision, Congress never imagined that late fees would be included in the term "rate or amount of interest." However, Congress was concerned about the possibility that state regulation of late fees might be preempted on the theory that late fees were a species of "other charges." It was to allay this fear that the Senate Banking Committee pointedly declared that § 501(a)(1) did not preempt "limitations on . . . late charges or similar limitations designed to protect borrowers." S. Rep. No. 96-368, *supra*, at 19, 1980 U.S.C.C.A.N. at 255.[8]

3. *Sections 511, 521, 522, And 523 of Title V All Have The Same Express Preemption Clause That Is Aimed At State Usury Ceilings.*

After the Senate amended DIDA in 1979 to include what became § 501, the Senate subsequently added other provisions that similarly preempted state usury ceilings on other types of loans. Four of these provisions, §§ 511, 521, 522, and 523, included preemption clauses which, with immaterial differences, contain the following identical terms:

> If the applicable rate specified in this

7. The distinction is quite deliberate as shown by the fact that subdivision (a)(2) of § 501, which pertains to interest bearing deposits, refers only to "the rate or amount of interest" without any mention of "other charges."

8. *See also* H.R. Conf. Rep. N. 842, 96th Cong. 69, 79 (1980), *reprinted in* 1980 U.S.C.C.A.N. 299, 309 (stating that regulations of Federal Home Loan Bank Board would not preempt stronger state law protections against late fees — therefore reconfirming that state late fee laws survived preemption under § 501(a)(1).

> [provision] exceeds the rate [the lender] would be permitted to charge in the absence of this [provision], such [lender] may, notwithstanding any *State constitution or statute* which is hereby preempted for the purposes of this [provision], . . . charge on any loan. . . .

(Emphasis added). The legislative history of these identical texts shows that the underscored terms were repeatedly used to refer to state usury ceilings.

The underscored verbal formula appears to have first been used in the 1974 Brock Act, §§ 202 and 203, 12 U.S.C. § 1831a(a) et al., Title II, Pub. L. No. 93-501, 88 Stat. 1557. The heading of the Brock Act speaks for itself: "TITLE II — INTEREST RATE AMENDMENTS REGARDING *STATE USURY CEILINGS* ON BUSINESS LOANS." [Emphasis added.] Moreover, in explaining a companion provision[9] of the same Act that temporarily amended Section 85, Congress declared:

> Although the Committee concluded that evidence before it justified Federal action of an emergency nature as envisioned here, it is concerned that this action not be construed as

9. Pub. L. No. 93-501 §201. The amendment allowed national banks to charge interest on certain business and agricultural loans at a rate of 5 percent above the local federal discount rate. The amendment expired on July 1, 1977, because it was intended only to relieve lending pressure in three states, Arkansas, Tennessee and Montana, and to allow those states enough time to change their statutory or constitutional interest rate ceilings, which were then below prevailing rates. *See* S. Rep. No. 1120, 93d Cong., 3d Sess. (1974), *reprinted in* 1974 U.S.C.C.A.N. 6249, 6260. Those statutory and constitutional ceilings did not apply to late fees and, therefore, Congress never preempted the late fee limitations in those states.

> reflecting Federal policy of overriding state law in this area, *especially with respect to consumer and home mortgage loans.*

1974 U.S.C.C.A.N. at 6261 (emphasis added). There can therefore be no doubt that Congress carefully chose the words "constitution or statute" in order to avoid any impact on traditional consumer protection laws that are separate and distinct from state usury ceilings.

In fashioning the four provisions of Part V of DIDA, Congress adopted the Brock Act's terminology to achieve the same limited purpose. Although the text of §§ 511, 521, 522, and 523 were originally included in Senate Bill 1988, which died in committee, the four provisions were incorporated in Title V of DIDA in early 1980. Burke and Kaplinsky, *Unraveling the New Federal Usury Law,* 37 Bus. Law. 1079, 1096-97 & n. 102. During the Senate Floor debates, Senators Pryor and Bumpers, the authors of S. 1988, and Senator Proxmire, the floor manager, emphasized that the sole purpose of these nearly identical provisions was to eliminate state usury ceilings so that state chartered institutions could benefit from the inflation sensitive federal discount rate, just as their federal bank competitors were free to do under § 85. 125 Cong. Rec. 30655 (Nov. 1, 1979). The preemptive language was surgically confined to constitutional and statutory usury limits because the Senate undoubtedly concurred with Senator Bumpers' observation that it was "not . . . particularly healthy to be overriding state law." *Id.*

The narrow preemptive reach of all of Title V's provisions was again confirmed by the House Conference Report that was issued just a week before DIDA's final passage. This report discusses the Title V provisions under the heading "STATE USURY LAWS" and repeatedly characterizes each of the Title V provisions as preempting "State usury ceilings." H.R. Conf.

Rep. No. 96-842, supra at 78-79, 1980 U.S.C.C.A.N. at 308-09. Finally, during the Senate's discussion of the conference report on March 27, 1980, the day before DIDA was passed by the Senate, Senator Proxmire declared:

> Title V [removes competitive restrictions on state chartered lenders] by preempting various *usury* laws while giving each State the opportunity to re-establish its *usury* limitations if it desires to do so. . . .

126 Cong. Rec. 6900 (Mar. 27, 1980). (Emphasis added).

4. *The Pattern And Common Purpose Of Title V's Provisions Cast An Informative Light On § 521, And Beyond To § 85.*

Examining § 521 in relation to its sister provisions in Title V serves only to confirm the plain meaning of its express preemption clause. If state law protections against liquidated penalties are not preempted by § 501 because late fees are not an "other charge" distinct from the "rate of interest," it follows *a fortiori* that late fees cannot be forcibly merged into the term "rate of interest" in § 521. Congress' strong desire to preserve state laws that protect consumers against unlawful liquidated penalties, as expressed in the October 1979 Senate Banking Report, S. Rep. No. 96-568, *supra,* at 19, cannot be ignored in construing § 521. Although this Senate report was addressed to what became § 501(a)(1), the commitment expressed in this report to preserve consumer protection is relevant to construing the preemptive scope of DIDA as a whole. It is inconceivable that Congress would strive to protect consumers in the context of home mortgage loans but would suddenly bury the goal of consumer protection in the context of the credit card mass market which involves many thousands of people who cannot afford a car, much less a home.

Each provision of a statute must be construed in harmony with the statute's other provisions. *E.g., Massachusetts Mutual Life Insur. Co. v. Russell*, 473 U.S. 134, 147 (1985). A term in one section of a statute must likewise be construed consistently with the same term used in kindred sections of the same statute. *E.g., Firestone v. Howerton*, 671 F.2d 317, 320 n.6 (9th Cir. 1982). In accordance with these principles, it is clear Congress understood that § 521 only preempted constitutional and statutory usury ceilings in order to establish parity between state chartered and federally chartered lenders with respect to the rates of interest they could charge. The Congress of 1980 never imagined that the term "rate of interest" would include liquidated penalties imposed for *delinquent* loan payments. Because the purpose of § 521 was to afford state banks the same protection that national banks enjoyed under § 85, it follows that the 1980 Congress likewise understood that late fees were outside the preemptive reach of § 85.

CONCLUSION

The purposes of § 85 can certainly be accomplished without an "interest" definition that embraces "all charges," including penalty fees. This Court has specifically ruled that all contracts by national banks are "governed and construed by state laws." *Nat'l Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, (1870); *National Bank v. Johnson*, 104 U.S. at 277. Although this Court has also ruled that the word "located" in 12 U.S.C. § 85 has a firm, federal definition, *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 312, 313 (1978), it has never ruled that only the contract laws of a bank's home state may be applied to that bank.

A federal common law definition that excludes contingent late payment charges has no effect on intrastate lending by national banks. Because their contracts are governed by state

laws, national banks can utilize the same contractual terms as any other lender in the state. If other lenders are allowed to include late fee provisions in their contracts, there is no reason why a national bank would be prevented from doing the same as an incident to its power to contract. *See* 12 U.S.C. § 24 (Third). Because a national bank would also be free to use the highest interest rate allowed to any lender in the state, it would remain a "most favored lender."

In conclusion, the traditional common law definition of interest is in accord with the text of § 85, the historical setting and purpose of the statute and the precedents that have construed its meaning. This definition is the only definition that is consistent with the text and legislative history of § 521 of DIDA, the lineal descendent of § 85. The traditional definition also coincides with the definition of interest on deposits (*see* 12 U.S.C. §§ 371b, 371a), with the whole foundation for the Truth-In-Lending Act (*see, e.g., Vega v. First Federal S&L Ass'n*, 622 F.2d 918, 922 (6th Cir. 1980)), and with the principle that preemption may not be found in the absence of clear and unambiguous Congressional intent.

On the basis of the foregoing, Amicus submits that there is no credible proof, much less clear and unambiguous proof that § 85 was intended to eradicate age-old state law remedies that operate in a traditional field of state governance. Amicus, therefore, asks that the decision below be reversed.

Respectfully submitted,

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(9)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To
The California Supreme Court

AMICUS CURIAE BRIEF OF THE COMMONWEALTH OF MASSACHUSETTS AND THE STATES OF ARKANSAS, CONNECTICUT, FLORIDA, HAWAII, INDIANA, IOWA, KENTUCKY, MAINE, MARYLAND, MICHIGAN, MINNESOTA, MISSISSIPPI, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, NORTH DAKOTA, RHODE ISLAND, SOUTH CAROLINA, TENNESSEE, TEXAS, VERMONT, WASHINGTON, WEST VIRGINIA AND DISTRICT OF COLUMBIA IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST

The *amici curiae* Commonwealth of Massachusetts and the states of Arkansas, Connecticut, Florida, Indiana, Iowa, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Rhode Island, Tennessee, Texas, Vermont, Washington, and West Virginia through their Attorneys General, the District of Columbia through its Corporation Counsel, South Carolina's Department of Consumer Affairs through its Administrator, and Hawaii's Office of Consumer Protection through its Executive Director,[1] support petitioner Smiley's position that federal laws do not preempt California laws limiting excessive late payment penalties in credit card transactions. Preemption of these California laws will impede amici's authority to enforce their laws regulating credit card delinquency and late charges against out-of-state national banks.

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[1] The actual participants in this Amicus Curiae Brief are listed on the signature page. Of the 26 States participating, 23 are represented by the Attorney General of the state. Hawaii is represented by the Office of Consumer Protection which, while not part of the state Attorney General's Office, is statutorily authorized to undertake consumer protection functions, including legal representation of the state and enforcement of that state's consumer protection laws. The District of Columbia is represented by its Corporation Counsel. South Carolina is represented by its Department of Consumer Affairs which administers, enforces and interprets the South Carolina Consumer Protection Code which regulates late charges, overlimit charges, other default charges and debt collection practices in South Carolina. For the sake of simplicity, amici will hereafter be referred to as the "Attorneys General" or "States."

The Amici states have a great interest in this case. This Court's interpretation of the scope of the preemption of Section 30 of the National Bank Act, codified as 12 U.S.C. §§ 85 and 86, will have a profound impact on their protection of their citizens. This Court's decision will determine whether the Attorneys General may enforce state laws that limit excessive penalty charges and other non-interest terms in credit transactions entered into by their residents.

As the chief law enforcement officers of their states, the amici wish to emphasize their view, based on longstanding principles of statutory and constitutional interpretation, that acts of Congress which do not explicitly preempt state laws must not be read more broadly than Congress intended. This is of particular concern in a case such as this one where the state laws are based on a state's traditional police powers to protect consumers in credit transactions.

Consumer protection and consumer credit are traditional and critical areas of state concern. Amici states have established comprehensive regulatory systems to ensure fairness in the relationship between consumer borrowers and their creditors. These laws reflect each state's own assessment of how best to balance protecting consumers with providing creditors sufficient incentive to lend profitably to their residents.

SUMMARY OF ARGUMENT

The lower court's majority decision destroys a state's ability to enforce laws regulating late charges in consumer credit transactions. The decision also places in doubt the validity of every state's consumer credit laws by interpreting "interest" expansively for purposes of preemption analysis. This unwarranted intrusion into substantive state consumer credit policy misreads both the language and history of the federal statute at issue and the fundamental premise that a state's historic police powers can be negated only with a clear mandate from Congress.

The lower court's decision also undermines this country's dual banking system which has been one of the most significant characteristics of American banking since the National Bank Act was passed in 1864. Historically, Congress has deferred to the interests of the states in the regulation of national banks as to all matters except those essential to their role as federal instrumentalities.

Application of the decision's preemption analysis will permit a national bank to use the law of its home state to override the consumer protection legislation of California and all other states under the guise of federal preemption. Amici submit that Congress never intended this result.

ARGUMENT

I. THE LOWER COURT'S DECISION IMPROPERLY LIMITS STATES' POLICE POWERS AND WILL SERIOUSLY ERODE STATE CONSUMER CREDIT LAWS.

A. *Smiley* Improperly Elevates South Dakota Law, Not Federal Law, On Late Payment Penalties Above The Laws Of Every Other State, Regardless Of Each State's Distinct Legislative Decisions.

California prohibits the assessment of excessive late payment penalty charges on credit card accounts when consumers are delinquent in making payments.[2] These charges, however, are permitted in South Dakota. Citibank, located in South Dakota, imposes such charges on California residents. Citibank claimed, as the basis for its authority, 12 U.S.C. § 85 which, under certain circumstances, preempts state restrictions on interest rates. Respondent also relied on *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978),

[2] Consumer protection is a traditional and important component of the police power of the states. *Griffith v. Connecticut*, 218 U.S. 563, 568-569 (1910); *California v. ARC America Corp.*, 490 U.S. 93, 101 (1989). Typical areas of state consumer credit regulation include requirements of truthful advertising, restrictions or prohibitions on automatic wage assignments or authorizations to confess judgment, limitations on security interests and restrictions on debt collection charges and practices. The need for state regulation in this area has long been judicially acknowledged. *See Aldens, Inc. v. Packel*, 524 F.2d 38 (3rd Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. Miller*, 610 F.2d 538 (8th Cir. 1979), *cert. denied*, 446 U.S. 919 (1980).

as authority to export these charges throughout the country.

In order to override California law limiting excessive late payment penalty charges, the *Smiley* majority used a flawed preemption analysis to define the term "interest" in § 85 expansively to include late payment penalty charges.[3] Proceeding on this premise, shown below to be incorrect, the majority in *Smiley* incorrectly concluded that California law is superseded because the legislature of South Dakota permits the imposition of unlimited late payment penalty charges in consumer credit transactions.[4]

The result of the lower court's majority decision will be to enshrine South Dakota's policy of deregulation as a nationwide policy, regardless of other states' laws to the contrary.

[3] "Late payment charges exacted by credit card issuing banks totaled almost $2 billion in 1992, according to one industry source. (Credit Card News (Apr. 1, 1994) at p.2)." *Smiley* at Pet.App. 62 (Arabian, J., dissenting).

[4] South Dakota has legislatively expanded the definition of "interest" to be "compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation, points, loan origination fees, credit service or carrying charges, charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit." S.D. Codified Laws Ann. § 54-3-1 (1990).

B. *Smiley's* Holding Will Reach Beyond Laws Limiting Late Payment Penalty Charges To Eviscerate All State Consumer Credit Laws.

Although this case is limited to consideration of late payment penalty charges, national banks elsewhere, using *Marquette* as a lever, have attempted to push the preemptive force of § 85 to virtually all terms of credit transactions with consumers. For example, at least one national bank has argued that state laws limiting collection costs and attorney fees following default are preempted.[5] To support this position this bank has incorporated the following term in its credit card agreement:

> All terms and conditions of this Agreement (including the change of terms provision, the applicable law provision, and the finance charge, late charge, returned check charge, and research charge provisions) are deemed to be interest under this Agreement and material to the determination of the finance charge.[6]

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[5] *State of Wisconsin v. Ameritech Corporation, et al.*, Dane County Circuit Court Case No. 92CV1013 (1995) (complaint dismissed), Dst. IV, WI Ct. of Appeals, Case No. 95-3426 (appeal stayed pending decision in this matter). *See also Citibank (South Dakota), N.A. v. Thomas J. Miller as Attorney General of the State of Iowa*, C.A. 88-258-E (S.D. Iowa 1988); *State of Iowa v. Citibank (South Dakota)*, CE 029-16973 (Iowa District Court for Polk County, 1988). These cases were settled in November, 1989; no judicial decision on the merits was reached.

[6] This credit card agreement is part of the record in *State of Wisconsin v. Ameritech Corporation, et al.*, Wis. Ct. Appeals, Dst. IV, Case No. 95-3426, (R. 60, p. 4).

If this Court upholds *Smiley* and confirms the exportation theory promoted by some national banks, the states' legislative ability to balance consumers' interests with lenders' interests will be severely curtailed.

Lenders doing business in states with strong consumer protection measures will be at a competitive disadvantage against financing sources based in states which have forsaken consumer protection in order to attract banking interests.[7] National banks, located in states responsive to banking interests, eventually will dominate not only the credit card industry, but all credit markets.[8] The states that provide a greater measure of consumer protection will be confronted with the unenviable choice of eliminating these public protection provisions so that

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[7] Although the statutory basis for interest rate exportation is more than one hundred years old, this court first considered the issue in *Marquette*. Following that decision, several states chose to eliminate consumer safeguards in credit transactions to attract national banks. Ginsburg, *Interstate Banking*, 9 Hofstra L. Rev. 1133, 1370 (1981); Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions*, 42 Bus. Law 929, 933-34, 939 (1987). A few states' efforts to attract credit card issuers from other states have been successful. "Small States Teach a Big Banking Lesson," *Chicago Fed. Letter*, No. 10 (June 1986). Today, of the top ten credit card issuers, six are located in Delaware, while the respondent, the single largest issuer of Visa cards and Mastercards, is in South Dakota.

[8] In states with consumer credit laws in place, local merchants, such as appliance stores and car dealers, already offer financing from institutions located in states where consumer credit has been deregulated. *See Wiseman v. State Bank and Trust*, 854 S.W. 2d 725 (Ark. 1993) (interest rate for motor vehicle loan determined by law where bank is located).

local creditors may compete with out-of-state creditors or watching the local financing sources move elsewhere.[9]

C. The Decision Below Will Thwart State Efforts To Formulate And Enforce Nondiscriminatory Consumer Credit Laws.

It is appropriate for each state to define as a matter of policy and law consumer credit terms for transactions within its borders. States such as Delaware and South Dakota have the undisputed right to deregulate rates for their own citizens.[10] However, every state's right to set standards for fair practices in the consumer credit area within its respective borders will be curtailed if the decision below is upheld.

"Because credit has become a way of life for consumers, and their need for protection in that area is great, the most important protective efforts in the field of consumer protection in recent years relate to consumer credit

[9] *See, e.g.*, the Massachusetts Legislature's 1993 amendment allowing credit card late charges of up to $10.00 in place of its previous prohibition of such late charges, after the First Circuit allowed the preemption of that prohibition in *Greenwood Trust Co. v. Commonwealth*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993). Mass. Gen. Laws Ann. c. 140, § 114B as amended by 1993 Mass. Acts Chapter 151, § 43. The Wisconsin Legislature is considering a proposal to eliminate limits on late payment penalties, over-the-limit fees and other non-interest rate charges in the event this Court determines that late charges are "interest" under § 85. Wisconsin Senate Bill 505 (1996).

[10] Indeed, the *Smiley* court seems to have substituted its policy judgments for those of the California legislature. *See* discussion at Pet. App. 35 (e.g. "As a general matter at least, late payment has no social utility").

protection." 17 Am. Jur. 2d, *Consumer and Borrower Protection* § 1 (1990). State consumer credit laws reflect the now familiar differences between commercial transactions and consumer transactions.[11] Commercial transactions presumably involve two knowledgeable parties. One party does not rely on the other party for fairness or knowledge. Terms of a commercial agreement are usually understood, even if not expressly bargained for by the parties. The parties to a commercial transaction customarily have comparable economic positions or interests at stake, or can select their respective bargaining position in the marketplace.

On the other hand, consumer transactions are for personal, not business, use. Consumers frequently lack experience from repeated transactions and have a more limited knowledge of the marketplace than the seller. Most often, contractual documents are not read, much less bargained for, by consumers.

Under the lower court's ruling, consumers subjected to unfair or illegal credit and collection practices by an out-of-state national bank will have no recourse to their state consumer protection authorities.[12] These officials will be precluded from enforcing consumer credit laws

[11] For example, *see* Crandall, *The Wisconsin Consumer Act: Wisconsin Consumer Credit Laws Before and After*, 73 Wis. L. Rev. 334, 357 (1974).

[12] Courts have ruled that national banks have engaged in improper practices and have taken advantage of customers. *See Beasley v. Wells Fargo Bank*, 1 Cal. Rptr. 2d 446 (Ct. App. 1st Dist. 1991); *Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 108 Cal. Rptr. 845, 511 P.2d 1197 (1973).

against out-of-state national banks. Further, consumers will not be able to pursue private statutory or common law remedies. Moreover, consumer protection authorities in the state where the bank is located may be less motivated to take action against a local national bank based on complaints from consumers in another state.

States have expressly extended the territorial application of their consumer credit laws to ensure evenhanded coverage of all credit offers made to consumers within their borders. These efforts have included statutory invalidation of choice of law contract terms that provide that the law of a foreign state controls a consumer credit transaction.[13] As the drafters of the Uniform Consumer Credit Act recognized in the mid 1960's:

> The danger that creditors may be able to induce consumers to agree that the applicable law will be that of a creditors' haven that has no effective consumer credit protection has led to invalidating choice of law agreements except where the law chosen is that of the state of the consumer's residence." Uniform Consumer Credit Code [1968 Act], Comment § 1.201, 7 U.L.A. 595, 619.

State residents are entitled to and reasonably expect the protection of their own state's laws. Consumers should not be subject to the non-interest laws of other states. While the market arguably regulates the "interest rates" offered across state lines, it does not regulate back-

[13] For example, *see* Sec. 421.201(10)(a), Wis. Stats.; *Aldens, Inc. v. LaFollette*, 552 F.2d 745 (7th Cir. 1977), *cert. denied*, 434 U.S. 880 (1977).

end late fees or other penalties after a loan default. Banks usually do not compete on the basis of penalties for the contractual breach, nor are consumers particularly sensitive to those penalties when choosing credit cards. Because such penalties, like late fees, can be more oppressive than market-based "interest," the resident states have a superior interest in limiting such charges when compared to the interest of a bank's home state.

II. *SMILEY'S* UNWARRANTED INTRUSION INTO SUBSTANTIVE STATE CONSUMER CREDIT POLICY OVERLOOKS THE FUNDAMENTAL PREMISE THAT A STATE'S POLICE POWER CAN BE NEGATED ONLY WITH A CLEAR MANDATE FROM CONGRESS AND THE LANGUAGE AND HISTORY OF THE FEDERAL STATUTE AT ISSUE.

A. *Smiley* Refers To But Does Not Apply The Preemption Principles Developed By This Court.

"Consideration of issues arising under the Supremacy Clause 'start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purposes of Congress.' " *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992), citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The requirement that preemption be found only when there is clear evidence of Congressional intent applies to consideration of both express statutory preemption and implied conflict preemption. *Freightliner Corp. v. Myrick*, 115 S.Ct. 1483, 1488 (1995).

This axiom is essential to the states. Appropriate deference to state laws helps ensure that Congress does

not supersede state legislative enactments except through deliberate action. Principles of federalism demand no less.[14] By finding that state laws may be preempted by stretching the definition of a federal law, the majority opinion below is incompatible with this Court's preemption decisions.[15]

The majority in *Smiley* did not recognize the clear meaning and import of this Court's preemption decisions. The California Supreme Court initially reviewed the language of § 85 and concluded that the term "interest" was not defined.[16] Having done so, it should then have applied the standard set out in *Cipollone*: where there is

[14] As Chief Justice Rehnquist has emphasized: "Unless the requisite pre-emptive intent is abundantly clear, we should hesitate to invalidate state and local legislation for the added reason that 'the state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden.' " *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 643 (1973) (Rehnquist, J., dissenting) (quoting *Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 275 (1943)).

[15] As Justice O'Connor has explained, the right to preempt state law under the Supremacy Clause is an extraordinary power in a federalist system. The use of this power will not be implied unless Congress has made its intention clear. To depart from this standard would place in jeopardy the federalist system of joint sovereigns. *Gregory v. Ashcroft*, 111 S. Ct. 2395, 2399 (1991).

[16] The First Circuit Court of Appeals made the same error in *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993), by continuing its preemption analysis despite finding that " . . . DIDA's text and legislative history are, at bottom, inconclusive." *Id.* at 828.

no clear evidence of preemptive intent, a finding of federal preemption is foreclosed. This approach would have properly limited § 85 to its plain meaning – numerical interest rates. Instead, without conducting any preemption analysis whatsoever, the majority relied on *Marquette* for the proposition that § 85 preempts state laws relating to "interest," and framed the issue as one centering on the *scope* of preemption.[17] At this point the *Smiley* majority abandoned preemption principles and looked to secondary sources to define interest broadly to encompass any payments obtained from a borrower. Ultimately, the majority concluded that the power of South Dakota to dictate non-interest rate terms for California was "implicit" in the word "interest" as meant by the framers of the National Bank Act.[18] Both the plain meaning of the statute and its legislative history were ignored.

By forging ahead with an analysis of secondary sources while overlooking the purpose of § 85 and its

[17] In a separate opinion in *Cipollone* joined by Justices Kennedy and Souter, Justice Blackmun concurred with the majority and noted: "The principles of federalism and respect for state sovereignty that underlie the Court's reluctance to find pre-emption where Congress has not spoken directly to the issue apply with equal force where Congress has spoken, though ambiguously. In such cases, the question is not *whether* Congress intended to pre-empt state regulation, but to what *extent*. We do not, absent unambiguous evidence, infer a scope of pre-emption beyond that which clearly is mandated by Congress' language." *Cipollone*, 505 U.S. at 533. (Emphasis in the original.)

[18] "Had Congress intended to limit protection, it would doubtless have made itself plain. It did not. Its silence is especially deafening. . . . " *Smiley* at Pet. App. 24.

legislative history, the decision misapplied important preemption principles. The *Smiley* majority turned the *Cipollone* standard on its head by reasoning that because Congress did not speak plainly to preemption, it must have intended or implied limitless preemption.

B. Section 30 Was Enacted In 1864 As A Usury Statute That Prescribed The Rate Of Interest National Banks Are Permitted To Charge. The Scope Of Preemption Must Be Interpreted As Narrowly As Is Consistent With Its Plain Meaning.

The primary objective of Section 30 of the National Bank Act was to enact a federal usury law for national banks. This measure, today codified as 12 U.S.C. §§ 85 and 86, prescribed an interest rate ceiling and federal remedy for usury. It also protected national banks from discriminatory state usury laws under the "most favored lender" doctrine articulated by this Court in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874).

Discriminatory state usury laws are not at issue in this case. The explicit language of this statute does not speak to late payment penalty charges or credit terms other than the rate of interest. The majority in *Smiley* conceded correctly that language addressing late payment penalties or delinquency charges was not present in the statutory scheme. Further, the legislative history reveals no evidence of Congressional intent to displace

state law regarding penalty charges or payments other than for interest.[19]

The term "interest" in § 85 must be given federal definition, independent of unique state definitions. This principle was recognized by this Court in *Tiffany* which held that "interest" must "receive a strict, that is literal construction" to avoid subjecting banks to double interest penalties under the Act. *Id.* at 410. While maximum *rates* of interest would vary among the states because of different state interest rate ceiling laws, the *meaning* of interest rate for national banks would be uniform across all the states. *See National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (§ 85 of the National Bank Act federalizes the "rate" of interest, not the character of bank contracts).

In setting limits on rates of interest charged by national banks under the National Bank Act, Congress showed great deference to the states: the usury ceiling for a national bank would be the usury ceiling of that bank's home state. Respondent's attempt to use this provision of the Act, more than one hundred years after its passage, to engage in wholesale exportation of South Dakota's caveat emptor regime, thereby eviscerating the non-usury consumer protection laws of all the other states, turns upside down Congressional intent and violates Congressional deference.

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[19] Justice Arabian's dissent details the historical record regarding the enactment of the National Bank Act by the 38th Congress in 1864. The majority does not dispute this analysis, but takes the term "interest" out of its statutory context and looks to secondary sources as a basis for its expansive meaning.

The *Smiley* majority failed to point to evidence that by enacting a federal usury statute, Congress intended to preempt charges that were not customarily considered in determining compliance with these laws. The majority avoided historical authority and reasoning advanced in the dissenting opinions by suggesting that such authorities concern "lawful interest" in contrast to the more general concept of "interest" (*Smiley*, Pet.App. 20, n.8). However, this distinction would have made no sense to members of Congress in 1864. Today, this has no greater persuasive significance.

Section 85 preempts state usury laws but nothing more. In the 1860's, late payment penalties were not included in determining the rate of interest.[20] Therefore, late payment penalties were irrelevant to usury analyses, imposition of those penalties did not violate state usury laws, and the regulation of those penalties did not conflict with federal usury laws. Today, state laws limiting late payment penalty charges remain beyond the scope of federal preemption. The federal usury provisions of the National Bank Act look to the laws of a national bank's home state only to determine the maximum interest rate, not the laws that regulate (or more precisely, fail to regulate) late payment penalty charges.

[20] *See Gower v. Carter*, 3 Iowa 244 (1856); *Ramsey v. Morrison*, 39 N.J.L. 591 (1877); *Randall v. Home Loan & Investment Co.*, 12 N.W. 2d 915 (Wis. 1944).

C. There Is No Conflict Preemption Because State Laws Limiting Late Payment Penalties Do Not Make Compliance With § 85 Impossible Or Unduly Obstruct The Banking Business.

In the absence of express statutory preemption, conflict preemption may be implied where it is impossible to comply with both state and federal requirements, or where state law stands as an obstacle to achieving the intent of Congress. *Freightliner Corp. v. Myrick*, 115 S. Ct. 1483 (1995). As with express preemption, conflict preemption will not be found unless it is the clear intent and purpose of Congress. *CSX Transp., Inc. v. Easterwood*, 113 S. Ct. 1732, 1737 (1993).

When considering preemption under the National Bank Act, this Court has consistently and repeatedly recognized that state laws are not to be set aside simply to accommodate the commercial convenience of national banks.[21] In *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869), this Court stated:

> [National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than

[21] The *Smiley* majority suggests that these cases are inapposite because *Marquette* determined that state laws related to "interest" were preempted due to "conflict" with federal law. (*Smiley*, Pet.App. 12, n.4) However, Justice Brennan looked to the plain meaning of the statutory text to determine that the *rate of interest* was determined by the law of the state where the bank was located. *Marquette* did not hold that the preemption analysis of prior decisions under the National Bank Act was inapplicable when express terms of the Act do not conflict with state law.

> of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.

This principle has been balanced with national banks' role as federal instrumentalities. State action which conflicts with or frustrates the purpose of the federal act is void. *Davis v. Elmira Savings Bank*, 161 U.S. 275, 283 (1896). Almost one hundred years ago this Court reconciled these principles in *McClellan v. Chipman*, 164 U.S. 347, 357 (1896):

> These two propositions, which are distinct, yet harmonious, practically contain a rule and an exception, the rule being the operation of general state laws upon the dealings and contracts of national banks, the exception being the cessation of the operation of such laws whenever they expressly conflict with the laws of the United States or frustrate the purpose for which the national banks were created, or impair their efficiency to discharge the duties imposed upon them by the law of the United States.

The application of these principles to this case does not evidence a clear intent to preempt state laws as held by the majority below. First, it is not impossible for national banks to comply with both § 85 and nondiscriminatory state laws limiting late payment penalty charges and other non-interest terms so as to infer congressional intent to preempt contrary state law. National banks may comply with home state interest rate limits,

while conforming to laws governing non-interest charges and other terms of the states where their customers reside.[22]

Second, the *Smiley* majority did not demonstrate that the state laws limiting late payment penalty charges frustrated the purposes of the National Bank Act or somehow prevented banks from discharging their duties under federal law.[23] The federal duties or purposes of national banks were laid out in the National Bank Act and its legislative history and include: "to establish a system of

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[22] The majority's concern that limiting national banks to the "varying laws of the several states . . . might 'throw into confusion the complex system of modern interstate banking.' " (*Smiley*, Pet.App. 29), quoting *Marquette*, 439 U.S. at p. 312) is ill-founded. Justice Brennan was concerned about using the place of the transaction, not the customer's state of residence, as the basis for selection of the law to be applied. Moreover, sophisticated computer technology enables other interstate sellers to conform to consumer protection laws of states where customers reside. Today, creditors, other than financial entities under federal interest rate laws, operate on a national scale and extend consumer credit terms which comply with the laws of the states where the customer resides. *See Aldens, Inc. v. Packel*, 524 F.2d 38 (3d Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); *Aldens, Inc. v. Miller*, 610 F.2d 538 (8th Cir. 1979), *cert. denied*, 446 U.S. 919 (1980).

[23] The *Smiley* majority suggests that an obstacle to federal policies would exist if a state were to set interest rates to unprofitably low rates, yet permit lenders other than national banks to impose high penalty charges so as to drive national banks out of business. (Pet.App. 22) However, this scenario is not realistic. It assumes, *inter alia*, that favored banks would seek out chronic delinquents (and jeopardize repayment of principal and interest) so as to maximize late payment penalties.

national banking institutions, in order to provide a uniform and secure currency for the people and facilitate the operations of the Treasury of the United States." *Mercantile Bank v. New York*, 121 U.S. 138, 154 (1887).

State laws regarding credit terms other than the rate of interest do not impede, frustrate, or incapacitate national banks from achieving these federal purposes. The *Smiley* majority does not point to a real impediment created by requiring national banks to be subject to state laws in an area traditionally reserved to the states.

Furthermore, federal intervention in the consumer credit area does not occupy the field and foreclose state involvement apart from interest rate limits under usury laws. Far from evidencing a desire to occupy the entire field of consumer credit, the federal government's intervention in this area has been cautious, limited and deliberately deferential to state laws.[24] Generally, federal provisions only preempt state law when state law either offers less protection than, or is inconsistent with, the federal law.[25]

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[24] For example, the federal Truth-in-Lending Act, 15 U.S.C. 1601 *et seq.*, regulates consumer lending disclosures but explicitly leaves intact substantive state consumer protection laws. *See*, 15 U.S.C. sec. 1610. Similar deference to state law is demonstrated in the Equal Credit Opportunity Act, 15 U.S.C. secs. 1691-1691f (*see*, 15 U.S.C. sec. 1691d(f)), the Fair Debt Collection Practices Act, 15 U.S.C. secs. 1692-1692o (*see*, 15 U.S.C. sec. 1692n) and the Electronic Fund Transfers Act, 15 U.S.C. sec. 1693-1693r (*see*, 15 U.S.C. sec. 1693q).

[25] For example, the legislative history of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA), 12 U.S.C.A. § 1831, is instructive to an understanding of

The test for preemption is not inconvenience, nor even a claim of financial detriment to a private institution, but whether the state laws frustrate the purpose of the federal legislation. State laws are not preempted because they may modify defendants' options in a particular state; they are preempted only if they interfere with the federal purpose behind the National Bank Act. Absent federal preemption, states, not banks, and not even national banks, determine the laws, benefits and protection afforded to their consumers.

Congress' intent with respect to the notion of interest contained in the National Bank Act. "Although the NBA [National Bank Act] was enacted 100 years earlier, the same tensions, namely parity between federal and state lenders and preservation of local usury laws, were present and these conflicting considerations generated substantial concerns surrounding the passage of the earlier banking statute. The record of Congressional debate and deliberation concerning the enactment of DIDA strongly supports the understanding that preemption of credit-card regulation under DIDA is confined to traditional numerical interest rates . . . . Thus, the fact that Congress was specifically concerned about effecting a preemption limited to numerical interest rates is significant. If we cannot attribute to legislative initiative of 15 years ago the intent to include discrete, specialized charges within a definition of interest, we cannot ascribe that expansive definition of a legislative initiative that occurred over 100 years earlier." *Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94 slip op., Pet.App. 151, 160-64 (N.J. Nov. 28, 1995).

III. AGENCY INTERPRETATIONS SUPPORTING PREEMPTION UNDER § 85 ARE NOT ENTITLED TO DEFERENCE BECAUSE THEY CONTRADICT CONGRESSIONAL INTENT TO PREEMPT STATE CONSUMER CREDIT LAWS NARROWLY.

The decision below bolsters its expansive construction by reference to interpretations of the Office of Comptroller of the Currency (OCC) and its rulemaking proposal to define "interest" broadly to include almost any charge a national bank may impose upon a borrower. 60 Fed. Reg. at 11940 (March 3, 1995). Recently the OCC issued the final rule which includes such a sweeping definition of interest.[26] However, the lower court did not base its decision on these administrative actions which are entitled to neither weight nor deference.

Although the OCC rule purports to define "interest," the obvious consequence will be the wholesale preemption of state laws limiting charges not included in calculating a rate of interest imposed by out-of-state national

[26] The final text is as follows: "The term 'interest' as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports." 60 Fed. Reg. at 4869 (February 9, 1996). 12 C.F.R. § 7.4001(a).

banks.[27] However, Congress has never explicitly preempted state limitations on non-interest charges such as late charges, default charges or state limitations on charges related to collection costs, such as attorney fees.

The OCC's rulemaking attempt to preempt state laws conflicts with the spirit if not the letter of § 114 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, P.L. 103-328, Sept. 29, 1994, 108 Stats. 2338. That Act requires agencies to specify particular state banking laws which are to be administratively preempted. The OCC did not attempt in the preamble or in the text of the rule to identify those state laws, thereby depriving states of adequate notice of the potential preemptive impact of the proposed rule. Without such notice, many states may not realize that substantial portions of their versions of the Uniform Commercial Code, the Uniform Consumer Credit Code, the Retail Installment Sales Act and the common law of contracts, collections, attorney fees and penalties have been displaced by administrative fiat.

The legislative history of Riegle-Neal makes clear Congressional intent to narrowly preempt state consumer protection laws:

[27] The OCC's definition of "interest" does not apply to all transactions. In order to enable national banks located in states with fixed interest rate limits to avoid violating these usury laws – a likely result if late payment penalty fees and other charges were included as part of the interest rate – OCC's rule states that the definition is not to be used for credit extended within the state where the bank is located. 12 C.F.R. § 7.4001(c). The OCC offers no reasoned explanation for this approach.

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions. States have a legitimate interest in protecting the rights of their consumers, businesses, and communities . . . Congress does not intend that the Interstate Banking and Branching Efficiency Act of 1994 alter this balance and thereby weaken States' authority to protect the interests of their consumers, businesses, or communities. . . .
>
> It is of utmost concern to the Conferees that the agencies issue opinion letters and interpretive rules concluding that Federal law preempts state law regarding community reinvestment, consumer protection, fair lending, or establishment of intrastate branches *only when the agency has determined that the Federal policy interest in preemption is clear.*

H. Conf. Rep. No. 651, 103rd Cong., 2nd Sess. 53 *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074 (emphasis added)

Long-standing principles of administrative law prohibit giving any weight to the OCC's actions. First, there is no explicit congressional mandate to the OCC regarding § 85 or relating to the definition of the preemptive reach of the Act. The interpretations and rule definition do not advance traditional administrative objectives or fill in the gaps of statutory coverage or explain how the comptroller will exercise discretion in the future. Cf. *Perdue v. Crocker Nat'l Bank*, 38 Cal. 3d 913, 702 P.2d 503, 523, n. 38 (Cal. 1985), *appeal dismissed*, 475 U.S. 1001 (1986).

Second, the interpretations themselves are of questionable authority as they are not based on the banking

expertise of the agency. Instead they are quasi-judicial determinations of whether state consumer protection laws are preempted by federal banking laws.

Finally, as has been shown above, the conclusion advanced by the OCC – that interest rate includes other charges – cannot be reconciled with the plain language and Congressional intent of § 85. "[A]n agency's interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear . . . " *MCI Telecommunications v. AT&T*, 114 S.Ct. 2223, 2231 (1994). These recent interpretations and rulemaking are nothing more than an attempt to shore up the position of national banks in pending litigation. The courts, not an administrative agency without authorization from Congress, are the final authority on these issues of statutory construction. Administrative constructions which are contrary to clear congressional intent must be rejected. The OCC should not have attempted to accomplish indirectly what Congress only recently has refused to preempt directly.

CONCLUSION

For the above reasons, the judgment of the California Supreme Court should be reversed.

Respectfully submitted,

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No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari
To The California Supreme Court

BRIEF OF AMICI CURIAE TRIAL LAWYERS FOR PUBLIC JUSTICE, CONSUMER FEDERATION OF AMERICA, AND U.S. PUBLIC INTEREST RESEARCH GROUP IN SUPPORT OF PETITIONER

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INTEREST OF AMICI

Trial Lawyers for Public Justice, P.C. ("TLPJ"), Consumer Federation of America ("CFA"), and U.S. Public Interest Research Group ("PIRG") (collectively "amici") submit this brief as *amici curiae* in support of Petitioner Barbara Smiley (the "Cardholder").[1] As public interest organizations dedicated to consumer advocacy, amici contend that the decision of the Court below in *Smiley v. Citibank (South Dakota), N.A.*, 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995), should be reversed.

This is one of several cases brought by consumers throughout the United States who are standing up for their rights by challenging the unlawful late fees charged on credit card accounts by out-of-state banks.[2] At stake is the ability of the individual states to protect their citizens from the unscrupulous practices of out-of-state lenders who, through the guise of preemption principles, seek to unlawfully expand the scope of their home state's power so as to preempt, *inter alia*, other states' contract and consumer protection laws. Respondent Citibank (South Dakota), N.A. ("Citibank") is an out-of-state national bank that issues credit cards in California (and elsewhere), yet seeks to bypass California's contract laws.

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[1] Counsel for Petitioner and Counsel for Respondent have consented to the filing of this Brief. The respective letters of consent are being filed separately.

[2] Challenges to unlawful late fees have been successful in Pennsylvania and New Jersey. See *Mazaika v. Bank One, N.A.*, 439 Pa. Super. 95, 653 A.2d 640 (1994) (*en banc*), *alloc. granted*, 659 A.2d 557 (Pa. 1995); *Sherman v. Citibank (South Dakota), N.A.*, No. A-102-94, slip op., (N.J. Nov. 28, 1995) and *Hunter v. Greenwood Trust Co.*, No. A-103-94 slip op., (N.J. Nov. 28, 1995), reproduced at Pet. App. 129-224.

Relying on its home state's laws and a misinterpretation of federal law, Citibank charges California residents late fees and other penalties that are prohibited under California law. As a result of this widespread and unlawful practice, Citibank and other similarly situated banks reap staggering profits at the expense of consumers in California and other states that limit or outlaw late fee charges. This Brief is submitted in support of the Petitioner and other cardholders throughout the nation who have been and are being gouged by banks' unlawful late fee charges.

TLPJ is a national public interest law firm dedicated to using tort and trial law to advance the public good. Through involvement in precedent-setting and socially significant litigation, TLPJ seeks to protect the rights of consumers, safeguard civil rights and civil liberties, prevent toxic injuries, preserve the environment, defend workers' rights and strengthen the civil justice system. In its consumer rights litigation, TLPJ attempts to ensure that violations of consumer protection laws are remedied and deterred by compensating injured consumers. TLPJ is gravely concerned that, if state consumer protection laws are nullified through the improper application of the federal preemption doctrine, consumers will not be compensated for their injuries and violations of consumer protection laws will not be deterred. TLPJ has participated as an *amicus curiae* in litigation raising federal preemption issues before state and federal appellate courts throughout the country, as well as this Court. The federal preemption issues in which TLPJ has been involved include litigation regarding automobile design, medical devices, pesticides, hazardous substances, railroad safety, and atomic energy.

CFA is a non-profit consumer advocacy organization representing more than 250 local, state and national consumer groups with a combined membership of more than 50 million Americans.

PIRG is a national nonprofit, nonpartisan, research and advocacy organization. The group serves as the Washington, D.C. lobbying office for state PIRGs across the country.

All of the amici are deeply concerned about the potential impact of this case. If this Court fails to reverse the decision of the Supreme Court of California, millions of consumers will be adversely affected, and the ability of the individual states to protect their citizens through consumer protection and contract laws will be threatened. Congress did not intend this result. Accordingly, for the reasons set forth below, *amici* submit that the judgment of the Court below should be reversed.

SUMMARY OF THE ARGUMENT

The Court below has improperly expanded the definition of the federal term "interest" beyond its plain meaning to include "all lending charges", as defined by South Dakota law, and has thereby rendered the National Bank Act unconstitutional. This Court should not allow the Court below or Respondent to define federal law with reference to the home state's law, effectively elevating South Dakota law over the laws of California and the other states. To do so would allow South Dakota to legislate federal lending terms for the entire country in violation of the Supremacy, Commerce, and Full Faith and Credit Clauses of the United States Constitution. Congress could not have intended such an improbable result.

The informal letters and *amici* briefs of the Office of the Comptroller of the Currency ("OCC") cited by the Court below and by Respondent below are not entitled to any deference. Not only has the OCC overstepped its authority, but it has taken inconsistent and conflicting positions on the issues before this Court. Moreover, the current positions espoused by the OCC have no sustainable rationale.

Neither the size of a potential damage recovery, nor the banks' alleged "doomsday" prediction about the availability of consumer credit argued by Respondent and its *amici* below should prevent this Court from stopping the unlawful delegation of power to credit card issuer-friendly states, such as South Dakota, through the impermissibly broad reading of Section 85 made by the Court below. The policy arguments advanced by the Respondent and its *amici* below are meritless and should be made to Congress, not this Court.

ARGUMENT

I. THE CALIFORNIA SUPREME COURT'S INTERPRETATION OF MARQUETTE EFFECTIVELY RENDERS THE NATIONAL BANK ACT UNCONSTITUTIONAL

A. "Interest" Must Be Given a Federal Meaning.

The holding of the Court below, based on its interpretation of *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), improperly ties the scope of federal preemption directly to the potentially ever-changing legislation of an individual state that is home to a national bank. The California Supreme Court's holding that South Dakota can define the federal term "interest"

in Section 30 of the National Bank Act, 12 U.S.C. § 85 ("§ 85" or "Section 85"), and not merely the arithmetic rate, effectively permits South Dakota's legislative definition of that term to displace the contract laws and consumer protection laws of all other states. In so doing, the California Supreme Court has rendered the National Bank Act unconstitutional.

The decision of the Court below impermissibly broadens the definition of "interest" making it unconstitutionally dependent on the law of a bank's home state. Under normal circumstances application of a federal act does not depend on state law. *Jerome v. United States*, 318 U.S. 101, 104 (1943). Moreover, words used in a federal statute are to be given a federal meaning when a federal statute is "[i]ntended to be nationwide in its application". *New York v. Feiring*, 313 U.S. 283, 285 (1941). *See also Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 104 (1941) (removal statute which is nationwide in its operation, was intended to be uniform in its application). Accordingly, as this Court has made clear on a number of occasions, "interest" and "rate" in § 85 are to be given clear federal definitions that do not depend on unique state definitions.

In *Haseltine v. Central Bank of Springfield*, 183 U.S. 132 (1901), this Court concluded that "the definition of usury and the penalties affixed thereto must be determined by the national banking act, and not by the law of the state." *Id.* at 134. Similarly, in *Evans v. Nat'l Bank of Savannah*, 251 U.S. 108 (1919), this Court recognized that both "interest" and "usury" were determined by reference to federal law.

Likewise, in explaining the most favored lender concept of *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall) 409 (1874), this Court in *National Bank v. Johnson*,

104 U.S. 271, 277 (1881), said that the doctrine applies only "to the *rate* of interest, and not as to the character of [the bank's] contracts" (emphasis in *Johnson*).

The Court below failed to recognize that any reliance on a state definition is unconstitutional. Unless federal law directly provides the definition of interest in § 85, then Congress has unconstitutionally delegated to the South Dakota legislature the power to define federal lending terms. As one eminent jurist noted in the Pennsylvania Superior Court decision supporting the cardholders' position:

> The distinction to be drawn is that Congress may delegate power to states to establish rules or laws to be applied within their own borders, but it may not delegate authority to states to establish rules or laws for the entire country. . . .
>
> In my opinion, allowing Ohio law to define "rate of interest" in Section 85 of the NBA unconstitutionally enlarges the preemptive scope of the statute in that, by doing so, Congress is delegating to Ohio the power to legislate federal banking law for the entire country. The effect of this is to trump the individual states' consumer protection laws.
>
> Moreover, looking to state law to ascertain the preemptive reach of Section 85 produces absurd and unpredictable results. The Ohio legislature or judicial system may, at any time, alter or expand its definition of "rate of interest," thereby having further negative ramifications on this state's and other states' "non-interest rate" or consumer protection laws. Under this scheme, therefore, the legislature and/or courts of Ohio are completely unaccountable to the vast majority of cardholders – e.g., California cardholders – who are subjected to its laws. I cannot approbate such an application.

Mazaika, 653 A.2d at 656-57.

If "interest" and "rate" do no have clear federal definitions that do not include general contract terms and penalty charges, "interest" could have as many meanings as each state chose. Each state could define "interest" to include such things as attorneys' fees for collection or even court costs. The pitfalls of this approach were recognized by this Court in *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969), where it considered whether federal or state law defined the term "branch" in the National Bank Act. This Court emphasized that if state legislatures were permitted to define the federal term "branch", it would "make them the sole judges of their own powers," and that Congress "did not intend such an improbable result." *Id.* at 133-34.

Here, too, Congress did not intend for South Dakota to preempt the contract laws of California simply by revising the federal definition of interest to include penalty charges. *See Mississippi Band of Choctaw Indians v. Holyfield*, 490 U.S. 30, 44 (1989) (there is no reason to believe that Congress intended to rely on state law for the definition of a critical term in the statute).

B. South Dakota's Legislative Definitions of the Federal Term "Interest" Cannot Constitutionally Displace California Law.

In incorporating South Dakota's definition of interest into § 85, the Court below failed to recognize that Congress has never incorporated state law into a federal statute in any situation where one state's law would preempt other states' laws. Instead, Congress has limited

the incorporation of state law exclusively to those situations in which the state standard would operate only within the boundaries of the state itself, not in other states. *See, e.g., United States v. Sharpnack*, 355 U.S. 286 (1958) (addressing Assimilative Crimes Act of 1948, which adopted state law as the federal criminal law for military bases and federal enclaves located in each particular state).

The court below relied upon *Tikkanen v. Citibank (South Dakota), N.A.*, 801 F. Supp. 270 (D. Minn. 1992), to conclude that incorporation of state law was acceptable. That decision, however, also failed to recognize that Congress is only permitted to incorporate state standards that will operate *within* the boundaries of the state itself. The court below was unable to cite any other federal case in which Congress effectively adopted a boundless federal choice of law provision empowering one state legislature to overrule *all* of the contrary public policy decisions of another state legislature. In addition, the Court below utterly failed to address the significant differences between usury statutes, on the one hand, and the common law of contract penalties, on the other hand. In § 85, Congress only displaced the conflicting state penalties for usury. Because backend charges within a borrower's control never came within the ambit of such usury claims, but were instead regulated as a matter of contract law, Congress did not preempt those state law claims or principles.

The implications of this decision are immense. Were this Court to allow state law to define and redefine "interest" in § 85, it would lead to the unconstitutional result that Congress has authorized South Dakota to legislate federal lending terms for the whole country.

The Constitution simply does not allow banks to define federal law with reference to their own state's laws so as to obliterate the laws of California. "To vest the power of determining the extraterritorial effect of a State's own laws and judgments in the State itself risks the very kind of parochial entrenchment on the interests of other States that it was the purpose of the Full Faith and Credit Clause and other provisions of Art. IV of the Constitution to prevent." *Thomas v. Washington Gas Light Company*, 448 U.S. 261, 272 (1980); *see also Irwin v. Citibank (South Dakota), N.A.*, 26 Phila. 388, 1993 Phila. Cty. Rptr. LEXIS 59 (Ct. Common Pleas 1993) (§ 85 in a credit card case is unconstitutional to the extent it refers to state law to define "interest" and thereby preempts another state's law). Nor can the states constitutionally enlarge or diminish the scope of federal preemption by redefining the federal term "interest." *See Thomas*, 448 U.S. at 272 (Congress cannot make one state's law "supreme" to all others.)

C. The Decision of the Court Below Unconstitutionally Delegates Congressional Power to The Banks' Home States.

The Court must construe a statute to avoid serious constitutional problems unless such construction is plainly contrary to the intent of Congress. *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. and Constr. Trades Council*, 485 U.S. 568, 575 (1988). To construe "interest" in § 85 as being dependent on state law rather than federal law would render § 85 unconstitutional under U.S. Const. Art. I, § 1. That section provides that "[a]ll legislative powers . . . *shall be vested in a Congress* of the United States." U.S. Const. Art I, § 1 (emphasis

added). By permitting "interest" in § 85 to be defined pursuant to South Dakota law, the Court below has authorized Congress' delegation of such legislative authority to South Dakota. Such delegation violates Article I.

This Court has rejected such an approach in *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935). In that case this Court struck down a statute that delegated interstate policy-making authority to the President, who then adopted state laws as the operative restrictions. This Court focused on the absence of any guidelines limiting the scope or nature of the delegated authority in rejecting the open-ended delegation. *Id.* at 415. Moreover, the Court also found that the statute was defective because it failed to provide any "standard or rule" against which the delegated authority could be measured. *Id.* at 418.

The nondelegation doctrine is important for three reasons. First, it ensures that important choices of social policy are made by Congress and not by the individual states which are, by definition, unresponsive to the popular will of the nation. *See Industrial Union Dep't v. American Petroleum Inst.*, 448 U.S. 607, 685-688 (1980) (Rehnquist, J., concurring); *see also Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963). The doctrine also provides Congress' delegatee with an "intelligible principle" to guide the exercise of the delegated discretion. *Industrial Union*, 448 U.S. at 685-86 (citations omitted). Finally, "the doctrine ensures that courts charged with reviewing the exercise of delegated legislative discretion will be able to test that exercise against ascertainable standards." *Id.* at 686 (citations omitted).

The decision whether "interest" includes liquidated damages, attorneys fees, court costs or other contractual

penalties is a decision that should be made by Congress, not by an individual state legislature that is unaccountable to the will of the nation. *See id.* at 686. Moreover, since neither the language nor the legislative history of the National Bank Act provides any guidance to the states or to a reviewing court as to the scope of the word "interest" or the limits of the delegated discretion, no such delegation can be made. Indeed, as construed by the Court below, the most favored lender doctrine itself means that a bank's home state can define anything to be "interest." Because, under the Court below's interpretation, Congress has provided no definition, established no standard, laid down no rule and declared no policy separate from that of the individual states, the delegation is unconstitutional.[3] *Panama Refining*, 293 U.S. 421, 430.

Only Congress has the open-ended discretion to choose the object and ends of national legislation. *See* L. Tribe, *American Constitutional Law* § 5-17 at 363 (2d ed. 1988). Congress may not authorize individual states to choose between different legislative needs or to substitute the will of a state legislature for that of Congress where such state decisions will have an impact nationally or on residents of other states:

> Congress cannot simply delegate to the states the power to legislate in areas that are reserved to Congress – e.g., powers under the interstate commerce clause – but Congress may by federal legislation adopt and incorporate by reference state laws that already exist or that may exist in the future. For example, *Congress cannot delegate*

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[3] *Cf. Utah League of Insured Savings Ass'ns v. Utah*, 555 F. Supp. 664, 673-74 (D. Utah 1983) (a state legislature may not delegate its lawmaking power to the federal legislature).

to Illinois the power to legislate federal pollution standards for the whole country. Then Congress would be abdicating interstate commerce control to one state to legislate for the entire nation.

R. Rotunda, J. Nowak, J. Young, *Treatise on Constitutional Law – Substance and Procedure*, § 12.6 at 644 (1986) (emphasis added). *See also Yakus v. United States*, 321 U.S. 414, 425-26 (1944).

To allow South Dakota to define "interest" in § 85 and, in turn, the preemptive scope of the statute, is to allow the banks' home states to substitute their will for the will of Congress. But residents of California or any state other than South Dakota have no voting opportunity to influence the legislators in South Dakota. Absent such accountability, the delegation by Congress, as found by the Court below, constitutes a serious violation of the principles embodied in Articles I and IV of the Constitution.

If South Dakota has been empowered to expand the meaning of "interest" and "rate" so as to determine what credit terms are lawful, as the decision below implicates, then South Dakota has been delegated national lawmaking authority and Supremacy Clause powers. Allowing South Dakota not just to set a time-based rate required for a loan as permitted by *Marquette* but also to define the actual rights and liabilities of cardholders (*e.g.*, what does "late" mean; are attorneys' fees collectible) subverts the entire structure of the Union. Were this decision to stand, South Dakota could define "interest" and "rate" to include attorneys fees, court costs, foreclosure costs, collection costs, fair credit reporting exemptions or any other loan-related term that might arguably have an "indirect economic effect" on a lender's total return on its

loans. Such a result could not have been intended. Congress cannot delegate its national lawmaking power in such a manner. However, were the decision of the Court below to stand, it will have effectively done so.

II. THE REGULATORY MATERIALS CITED BY THE COURT BELOW AND RESPONDENT BELOW ARE INCONSISTENT AND ARE NOT ENTITLED TO ANY DEFERENCE

A. The OCC's Views Are Not Binding On The Court.

The Court below improperly agreed with Citibank's contention that judicial deference be given to an *amicus* brief and a string of informal opinion letters issued by the Office of the Comptroller of the Currency ("OCC"). The positions taken by the OCC, however, are not entitled to any deference for the following reasons: (1) this case involves a pure case of statutory construction where there has not been an administrative proceeding before the OCC; (2) the presumption against preemption overrides any deference that might otherwise be accorded to the OCC's positions; (3) they were not issued by the Comptroller in many instances; and (4) they are inconsistent with other OCC interpretations of § 85.

This Court has instructed that, in a case like this one that involves "a pure question of statutory construction," where there has not been an administrative hearing, deference to an administrative agency's interpretation is inappropriate. *See I.N.S. v. Cardoza-Fonseca*, 480 U.S. 421, 446 (1987). Although the Court has on occasion accorded "great weight" to the OCC's views on the National Bank Act, it has done so only where there has been an adjudicatory proceeding before the OCC, such as the granting

of a bank's application to sell annuities or establish a discount brokerage subsidiary. *See, e.g., NationsBank, N.A., v. Variable Annuity Life Ins. Co.*, ___ U.S. ___, 115 S. Ct. 810 (1995) (annuities); *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388 (1987) (brokerage). In such cases, the Court has respected the type of statutory interpretation that necessarily flows from the application approval process. In contrast, where, as here, the question focuses on a narrow issue of Congressional intent, and not on the broad issue of how the statute should be applied, the Court does not accord the same deference to agency interpretations. *Cardoza-Fonseca*, 480 U.S. at 446. The narrow issue of Congressional intent is a purely legal question that this Court should decide independently "using traditional tools of statutory construction." *Id.* at 448-49.

This rule is mandatory when, as here, federal preemption is at issue. Congress, not an agency opinion, must determine the scope of federal preemption. *See Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 151-52 (1963). In fact, courts may defer to agency opinions only where a statute is "silent or ambiguous." *Chevron*, 467 U.S. at 843 ("If the intent of Congress is clear, that is the end of the matter"). When a statute is "silent or ambiguous" as to federal preemption, however, the presumption against preemption requires a court to hold that federal law does *not* preempt state law. *See Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S. Ct. 2608, 2617 (1992) (preemption, if it is intended, must be "clear and manifest"). Therefore, when, as here, the question involves federal preemption, deference to an agency interpretation is misplaced because the very ambiguity that permits such deference proves that Congress had no

clear and manifest intent to preempt state law.[4] In short, the two concepts, agency deference and preemption, are doctrinally inconsistent and cannot coexist where Congress has not already addressed the preemption question.

Another reason that the banks' agency letters are not entitled to deference is that they were written by staff attorneys, not by the Comptroller. The OCC itself has represented to this Court that informal letters by staff members are not binding, are not reliable and do not constitute final agency action. *See* Brief For the Federal Petitioners filed in *NationsBank, N.A. v. Variable Annuity Life Insurance Co.*, Nos. 93-1612, 93-1613, brief at 38, n. 19 (U.S. filed July 29, 1994) (Amici Br. App. 8). *See also New York Stock Exch. v. Bloom*, 562 F.2d 736, 741 (D.C. Cir. 1977); *American Land Title Ass'n v. Clarke*, 743 F. Supp. 491, 494 (W.D. Tex. 1989). In addition, these letters vary in their reliance on state law to define "interest." Thus, the only agency opinions that are entitled to any deference in this case are those written by the Comptroller himself, both of which conclude that *late fees are not interest*.

Indeed, as the Supreme Court of New Jersey pointed out in *Sherman* when it rejected identical arguments proferred by Citibank, the significant inconsistent administrative treatment of "interest" with respect to the National Bank Act precluded deference to, or reliance on, the OCC interpretation (Pet. App. 174).

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[4] As this Court stated in *Gregory v. Ashcroft*, 501 U.S. 452, 464 (1991), "[t]o give the State-displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure on which *Garcia* relied to protect States' interests'," citing L. Tribe, *American Constitutional Law* § 6-25, p. 480 (2d ed. 1988).

Prior to August, 1988, the OCC consistently took the position that the interest referenced in Section 85 had a federal meaning. In the OCC Letter dated June 25, 1964, Controller Saxon took the position that charges for late payments were not properly characterized as interest (Amici Br. App. 1-3). In a letter dated October 29, 1965, Controller Saxon again declared that late fees are not interest (Amici Br. App. 4-6).

Then, in 1986, when the OCC was asked whether late fees were "interest" that could be exported under Section 85, the OCC refused to provide the answer (Pet. App. 172-173).

In 1988, the OCC added a new dimension to the confusion when it issued Interpretive Letter No. 452, which dealt with the issue of whether various fees charged by an out-of-state national bank to its credit cardholder in Iowa were interest. The agency concluded that under Section 85 the laws of a national bank's home state determine whether particular fees are material to the interest rate determination (Pet. App. 173). This letter conflicts with earlier and later OCC opinions, but has formed the basis for the decisions in *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert denied*, ___ U.S. ___, 113 S. Ct. 974 (1993), and its progeny.

Then, in a letter by Peter Liebsman, Assistant Director, Bank Operations & Asset Division, on February 26, 1993, the OCC completely affirmed its earlier position that state law defined "interest" under Section 85 (Pet. App. 173-174).

Thereafter, in an Amicus Brief filed on February 1, 1995, in *Sherman v. Citibank*, (NJ), the OCC completely reversed its position, contended that "interest" must have

a federal definition and admitted that its 1988 interpretive letter and earlier briefs "overstate[d] the role of state law." (Amici Br. App. 26).

"An agency interpretation of a relevant provision which conflicts with the agency's earlier interpretation is entitled to considerably less deference than a consistently held agency view." *Cardoza-Fonseca*, 480 U.S. at 446 n.30 (citations omitted). The OCC's recent views are inconsistent with Comptroller Saxon's own interpretation of "interest" in 1964: "*Charges for late payments . . .* are illustrations of charges which are made by some banks which *would not properly be characterized as interest.*" OCC Letter, Saxon, J. (June 25, 1964) (emphasis added) (Amici Br. App. 1-3). In addition, the OCC's recent views conflict with a 1965 interpretation by the Comptroller (Amici Br. App. 4-6) and with the government's construction of the associated term "discount rate" in § 85.[5] In defining interest in § 85, the OCC has taken numerous inconsistent or conflicting positions, as noted by the Supreme Court of New Jersey. Since the OCC's recent views on § 85 are anything but consistent, its opinions should not be

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[5] Neither the OCC nor the banks have explained (nor can they explain) why a national bank which uses the "discount rate" standard must abide by the late fee laws of the consumer's state, but may disregard those laws when it exports the "interest rate" of its home state. The only sensible construction is that a lender may use only a time-based rate or a required charge *for* a loan from its home state, excluding penalty charges, *or* the discount rate alternative, whichever is greater. If penalty charges were included in one alternative but not in the other, a lender could not intelligently choose between the two alternatives.

accorded the "substantial deference" suggested by the banks.[6]

B. The OCC's New Proposal Is A Post-Hoc Rationalization That, Without Any Sustainable Rationale, Improperly Redefines "Interest."

The OCC's latest inconsistency on this issue is in a proposed rule in which the OCC now attempts to redefine "interest" as follows:

> (a) *Definition*. The word "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for [1] any extension of credit, [2] the making available of a line of credit, or [3] any default or breach by a borrower of a condition upon which credit was extended.

60 Fed. Reg. at 11,940 (proposed for comment on Mar. 3, 1995).

Under this greatly expanded definition, "interest" would include all loan-related charges.[7] Even attorneys'

[6] The OCC is not the only organization to take conflicting positions that impact this litigation. In its 1994 10K Dean Witter, Discover & Co. (Greenwood Trust Discover Card) defines, "non-interest revenues" as fees from, *inter alia*, cardmember fees and servicing fees (Amici Br. App. 15). One would suppose that "interest" would mean the same thing to investors as credit card holders. This definition completely contradicts Greenwood's position in *Greenwood Trust Co. v. Massachusetts, supra, Hunter v. Greenwood* (NJ) and every case in which it has been a party.

[7] The plain and ordinary meaning of interest is that it is compensation for the "use of money owed to another." *Miller v. Robertson*, 266 U.S. 243, 257 (1924). "Interest . . . cannot be predicated on anything other than a loan of money." *Title Guaranty & Surety Co. v. Klein*, 178 F. 689, 691 (3d Cir. 1909).

fees incurred in collecting on a defaulted note would be "interest," as would penalty charges long disallowed by this Court. *See Loudon v. Taxing Dist.*, 104 U.S. 777 (1882) (disallowing a charge that was not interest for the use of money).

In describing this new definition, however, the OCC inconsistently states that up-front expenses, traditionally recognized as "interest," will no longer be deemed interest. *See* 60 Fed. Reg. at 11,929 (excluding appraisal fees, document preparation fees and other closing costs); *but see* Opinion of Julie L. Williams, OCC Chief Counsel (Feb. 17, 1995) at pp. 5-6 (asserting that such expenses are interest).[8] The OCC does not explain any basis for this new distinction, nor does it provide any rationale for its new definition. In short, the OCC's new rule is neither a fair construction based on the text and structure of § 85, nor "an attempt to interpret the language of the statute, [to] fill in the gaps in the statutory coverage, or to explain how the Comptroller will exercise his discretion." *Perdue v. Crocker Nat'l Bank*, 702 P.2d 503, 523 & n.38 (Cal. 1985), *appeal dismissed*, 475 U.S. 1001 (1986).

The OCC's newly proposed rule also is not entitled to deference because it is ad hoc and was arrived at in connection with the current litigation, solely to rationalize the result the OCC had already reached. *See Atchison*,

"Interest," therefore, does not include charges for loan defaults or loan options. *See, e.g., Walker v. First Pennsylvania Bank, N.A.*, 518 F. Supp. 347, 353 (E.D. Pa. 1981) (a charge for an option or commitment is not interest).

[8] Under the OCC's proposed interpretation, the closing expenses in *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855 (6th Cir. 1972), would *not* be "interest" within the meaning of § 85.

Topeka and Santa Fe Ry. Co. v. Pena, 44 F.3d 437, 442-43 (7th Cir. 1994) (en banc) (refusing to defer to administrative construction developed only after litigation was commenced); *Martin v. Refrigeration School, Inc.*, 968 F.2d 3, 7-8 (9th Cir. 1992) (same). The obvious purpose of the proposed interpretation is to bolster the position of the OCC and the banks in this and other cases pending nationwide. The proposal does not, however, advance a common law definition of the statutory terms[9] or undertake any type of textual analysis. Because it is just a naked response to pending litigation, the proposal is not a reasonable interpretation of § 85.

Absent some sustainable rationale, an agency's legal interpretation is not entitled to deference. *Koray v. Sizer*, 21 F.3d 558, 562-63 (3d Cir. 1994), *rev'd on other grounds*, ___ U.S. ___, 115 S. Ct. 2021 (1995). The OCC's proposed rule does not have any sustainable rationale because the OCC cannot cite even one pre-1992 case holding or even suggesting that single-sum contingent charges are interest rates. The rule ignores the many cases holding that such charges are not interest rates and are illegal. *See, e.g., United States v. Childs*, 266 U.S. 304, 307 (1924) (a penalty is a means of punishment whereas interest is a means of compensation); *New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (charges in excess of time based interest not allowed). In addition, the OCC relies on cases

[9] It is a "settled principle of statutory construction that, absent contrary indications, Congress intends to adopt the common law definitions of statutory terms." *United States v. Shabani*, ___ U.S. ___, 115 S. Ct. 382, 384 (1994). Here, there is no indication that Congress intended the OCC to uniquely define the § 85 terms "interest" and "rate". Instead the common law definitions of "interest" and "rate" must control.

involving *"id quod interest,"* measuring "the difference between the creditor's current position and what it would have been if the loan had been timely and fully repaid." *Library of Congress v. Shaw*, 478 U.S. 310, 316 n.2 (1986).[10] But prejudgment interest has never included sum-certain penalties like late fees. *United States v. Texas*, ___ U.S. ___, 113 S. Ct. 1631, 1635 (1993). In fact, a lender was not allowed to recover more than *"id quod interest"* for a loan default. *Loudon v. Taxing District*, 104 U.S. 771 (1882); *New Orleans Ins. Co.*, 83 U.S. (16 Wall.) at 386. Therefore, the proposal's assertion that late fees are "interest" ignores relevant precedent and misinterprets the plain meaning of § 85.

The proposed rule lacks a sustainable rationale for other reasons as well. The rule continues to rely on both the same informal staff letters that erroneously define "interest" pursuant to *state* law and the same cases that use a state law definition. Yet, the OCC now concedes that federal law must define the federal term "interest rates."[11] Since the staff letters do not contain a *federal*

[10] Examples of "id quod interest" are found in *Shoemaker v. United States*, 147 U.S. 282 (1983) (interest accrues or runs) and *Brown v. Hiatts*, 82 U.S (15 Wall.) 177 (1873) (same). *See also Wilkerson (Wilkerson) v. Daniels*, 1 Greene 180, 188 (Iowa) (1848) (periodic rate); *Daggett v. Pratt*, 15 Mass. 177 (1818) (same); *Wernwag v. Mothershead*, 3 Blackf. 401 (Ind. 1834) (same); Letter from L.A. Jennings, Deputy Comptroller of the Currency (February 24, 1955) (same).

[11] It is especially curious that the OCC continues to rely on the individual views of its staff members as authority (*see, e.g.*, OCC Feb. 17, 1995 letter at p. 6 n.9) since in other litigation it has taken the opposite position and has successfully argued that such individual opinions are not entitled to deference. *See NationsBank of N.C. v. Variable Annuity Life Ins.*, ___ U.S. ___, 115

definition of interest, or even discuss single-sum penalty charges, they obviously do not support the OCC's new federal definition that includes penalty charges and attorneys fees as "interest."

Discount interest is collected at the outset of a loan and can never include contingent sum-certain late fees that might not ever arise. Congress must have intended that the two alternative *"rates"* in §§ 85 and 521 (discount rate plus 1% or home state rate) would be measured the same way and would include or exclude the same types of charges. Otherwise, the regulated banks could not compare the two rates and could not make an intelligent choice between the discount rate alternative and the home state rate. As the Court reasoned in *Gustafson v. Alloyd Company*, ___ U.S. ___, 115 S.Ct. 1061 (1995), if Congress had intended a different, broader meaning for periodic "interest" than for discount "interest" in §§ 85 and 521, then Congress was required to express that difference in the text of the statutes themselves. *See Gustafson*, 115 S. Ct. at 1067-69 (Congress is presumed to intend a consistent meaning). Because "discount rate" in § 85 necessarily excludes sum-certain contingent charges like late fees, Congress must have intended that "interest at the rate" would also exclude such contract penalties.

S. Ct. 810, 816 (1995). The OCC cannot have it both ways – either the individual staff opinions are or are not entitled to deference. Moreover, not one of these individual opinions addresses single sum penalty charges.

C. The OCC Has Exceeded Its Authority By Attempting to Redefine "Interest" in § 85

In publishing the proposed rule, the OCC has exceeded the authority granted to it by Congress. For example, the OCC has demonstrated in the proposed rule that it will not follow Supreme Court authority requiring a common law definition of "interest." The OCC has argued, in effect, that "interest" in § 85 should *not* be limited to its common law meaning, but that the OCC should be able to redefine the term at any time based on its own perception of changing economic conditions and requirements of the Country. Incredibly, the OCC says it should be able to preempt California and other states' consumer protection laws simply by administratively expanding the definition of "interest" in § 85 beyond the ordinary, common sense meaning intended by Congress.

Contrary to this position, there is no indication that Congress intended an administrative definition instead of the common law definition. Nor is there any proof that Congress delegated boundless interpretive powers to the OCC, without any standards to guide or limit the OCC's purported authority. This Court should reject the OCC's attempt to enlarge its authority.

The OCC contends, however, that Congress has granted it broad powers to interpret all federal banking laws, including those pertaining to preemption.[12] If that

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[12] In the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994, Public Law 103-328, § 114, Congress did not grant the OCC power to preempt state law. Rather, it required that any opinion by the OCC that might have a preemptive impact must first be published for notice and comment. The two are vastly different. *See* H. Conf. Rep. No.

were the case, then such a boundless delegation from Congress would not pass muster under the standards set forth in *Panama Refining Co. v. Ryan*, 293 U.S. 388. Where, as here, Congress has not provided any guidelines or standards for determining the scope of federal preemption or for checking the exercise of delegated authority, the delegation is unconstitutional. *Id.* at 418, 421. The only way to avoid that result is to construe § 85 narrowly so as not to confer limitless interpretative authority on the OCC. *See Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (construing a federal statute so as not to preempt a California law and thereby avoiding a difficult issue of whether Congress improperly delegated authority to a federal agriculture board).

D. The OCC's New Redefinition Of "Interest" Cannot Be Applied Retroactively.

Besides exceeding its authority in issuing the proposed rule, the OCC apparently hopes to apply the rule retroactively. But even if the rule becomes final, its only application will be prospective. It will not have any binding effect in these cases.

In *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), this Court held that agencies may not issue retroactive rules unless Congress has expressly granted them the authority to do so. Noting that "[r]etroactivity is not favored in the law," the Court reasoned:

651, 103d Cong., 2d Sess. 55 (1994) (the notice "process is not intended to confer upon the [OCC] any new authority to preempt or to determine preemptive Congressional intent").

> [A] statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress *in express terms* . . . . Even where some substantial justification for retroactive rulemaking is presented, courts should be reluctant to find such authority absent an *express statutory grant*.

Id. at 208-09 (emphasis added) (citations omitted). Here, there is no express statutory grant allowing the OCC to issue rules that will be given retroactive effect. Accordingly, the OCC's proposed redefinition of "interest" may not be applied retroactively. *See also* Administrative Procedure Act, 5 U.S.C. § 551(4) (governing all interpretive rules and defining them as having only future effect).

E. The OCC Disregards Public Policy Concerning Penalties Imposed Against National Banks.

This Court has held that, because a violation of § 85 subjects a national bank to a "penalty", it must "receive a strict, that is literal construction." *Tiffany*, 85 U.S. (18 Wall.) at 410. Therefore, unless § 85 "clearly prohibits" the taking of a greater rate of interest, the Court must conclude the transaction is outside the scope of the National Bank Act. *Id.* at 410-411. This Court, citing *Tiffany*, has long recognized that a national bank "is not to be subjected to a penalty unless the words of the statute plainly impose it." *Keppel v. Tiffen Savings Bank*, 197 U.S. 356, 362 (1905).

The OCC disregards this Court's construction of the National Bank Act and requests this Court to define interest "broadly." *See, e.g.*, OCC letter of Feb. 17, 1995 at 5 (stating that "Congress intended for the term 'interest'

in Section 85 to be understood broadly to include any kind of lending charge . . . "). A broad definition of interest is also reflected in the OCC's proposed interpretive rule. Under the OCC's revised interest definition, national banks will be subject to § 86 claims not just for excess "interest" under a "strict" and "literal" interpretation, and for claims that it overcharged for expenses, attorneys' fees and many other kinds of charges. Congress did not intend that result.

III. THE POLICY ARGUMENTS OF THE BANKS AND THEIR AMICI SHOULD BE MADE TO CONGRESS, NOT TO THIS COURT, AND ARE, IN ANY EVENT, MERITLESS.

In the court below the bank and its *amici* below have raised a number of policy arguments that should be made to Congress, not to this Court. The Court's role is to interpret and apply § 85 as enacted by Congress, not to rewrite legislation to address the banks' and its *amicis'* policy concerns. If the bank and its *amici* think that enforcement of § 85, as written, is contrary to public policy, they should take the matter up with Congress. Their arguments are matters of legislative policy that simply do not belong in this Court. Moreover, their arguments are wrong.

For example, the California Bankers Association, American Bankers Association, American Financial Services Association and Consumer Bankers Association ("banking associations") have argued to the Courts below that because lenders "compete on the basis of an entire package of loan fees that are inextricably related to each other," "interest" in § 85 should be interpreted to include a lender's total loan package. That argument is wrong,

not only because it was rejected by this Court in *New York Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, ___ U.S. ___, 115 S. Ct. 1671 (1995), but also because lenders generally compete based on interest charges that consumers know will be charged, not on an amount of late fees that might never be incurred.[13] In any event, the argument is purely a matter of policy. As this Court made clear in *Marquette*, 439 U.S. at 319, "the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of the Court."

The banking associations and Respondent's *amici* below also have offered numerous other arguments in this proceeding and in the other state litigation on these issues that are incorrect, involve policy and are not supported by evidence in the record. Visa U.S.A Inc. and Mastercard International Inc. ("Visa & Mastercard"), for example, have argued that prohibiting late fees will require credit card issuers to raise periodic percentage interest rates and restrict the availability of credit to high risk borrowers. Those contentions are wrong, however, both theoretically and factually. They are wrong because they necessarily assume a non-competitive market for credit cards. In a truly competitive market, the absence of

[13] Because most consumers do not plan ahead of time to default on timely payment of their credit card bills, they do not plan to incur late fees. They, therefore, shop for credit cards based on the amount of interest that definitely will be charged, not on the amount of late fees that might never be charged. Consumers do not know from the start the total amount of late fees that eventually will be charged; the late fees are essentially hidden charges that do not factor into the consumer's choice of a credit card account.

late fees would not impact low risk borrowers because the card issuers would continue to offer low rates to attract and retain those customers. The same competitive principle would also apply to higher risk borrowers, except that they would be charged slightly higher rates.[14] Besides, because this case was dismissed on a motion to dismiss, there is no evidence in the record to support the conclusion that permitting late fees will increase the number of consumers who may qualify for a credit card. In addition, today a majority of the states permit late fees so that such arguments are, at a minimum, inapplicable.

As many card issuers have already ascertained, the banks can restructure their penalty charges to coincide with the varying risks of their credit card loans. For example, with each default, a lender can increase the applicable periodic rate to account for that default. Because the rate would account for the duration and amount of the default, unlike sum-certain late fees, it would truly reflect the risk variable. Of course, market forces naturally would tend to limit the size of the rate increase. Since a borrower could transfer his or her balance to a competing card issuer to minimize the effect of the default rate increase, the card issuer would have an incentive to keep the rate increase from becoming too

[14] For truly high risk borrowers, such as those who are overextended and unable to pay their bills, it is far from clear that limiting late fees has had or will have any appreciable effect on the availability of credit. Even if such borrowers are left with less credit options, that result is not contrary to sound public policy. Public policy does not and should not require that overextended borrowers be allowed to overextend themselves even further so as to inevitably burden the bankruptcy courts and public assistance programs.

high. Of course, the fear of such balance transfers is what has kept card issuers from instigating such rate-based risk adjustments to replace sum-certain penalties. In short, the card issuers prefer sum-certain default fees that enable them to punish, yet not lose, customers who have missed a payment.

Another empty policy argument parroted below throughout many of the bank *amici* briefs is that requiring national banks to comply with the laws of the states where they solicit and conduct credit card business would be administratively difficult and disruptive to interstate lending. Contrary to the bank amici's claims, compliance would not be expensive or difficult. In fact, many credit card issuers already abide by applicable state restrictions and note in their disclosure charts that penalty fees are not imposed in a list of states identified by abbreviations. (Amici Br. App. 9-11). While Respondent here might incur some expense in researching and copying the same charts, given the staggering profits that could have been made from their late fees, these banks easily could afford such a minor expense.

The bank amici also complained below that, in imposing the late fees, national banks have relied on the informal OCC opinions holding that "interest" in § 85 encompasses late fees. The implication is that, if Petitioner Cardholder's interpretation of § 85 is correct, these banks will face sizable liability. However because the amount of the banks' liability is not at issue at this stage of the litigation, the potential exposure argument is premature and irrelevant. In any event, accepting that argument would encourage huge corporations to exceed the bounds of lawful activity, believing that they would never have to answer for their misconduct, because the

liability would be too great. Finally, declining to hold Citibank accountable for its misconduct because the liability would be too great would reward Citibank at the expense of other national banks that have abided by late fee restrictions in California and elsewhere. *See, e.g.*, Amici Br. App. 9-11 (exemplar of Visa credit card application noting that late fees would not be charged in states like California). Such a result would be unjust, unwarranted and untenable. Congress did not intend this.

CONCLUSION

The judgment of the Court below should be reversed.

Respectfully submitted,

Adele P. Kimmel Trial Lawyers for Public Justice, P.C. 1717 Massachusetts Avenue, N.W. Suite 800 Washington, DC 20036 (202) 797-8600	Ann Miller (Counsel of Record) Spector, Gadon & Rosen, P.C. 1700 Market Street, 29th Floor Philadelphia, PA 19103 (215) 241-8888

Counsel for Amici Curiae

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari
To The California Supreme Court

APPENDIX TO BRIEF OF AMICI CURIAE TRIAL LAWYERS FOR PUBLIC JUSTICE, CONSUMER FEDERATION OF AMERICA, AND U.S. PUBLIC INTEREST RESEARCH GROUP IN SUPPORT OF PETITIONER

TABLE OF APPENDIX

EXHIBIT B

JUN 25 1964

In your letter of May 22, 1964, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each questioned transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be please [sic] to furnish such information upon request.

Sincerely,

(Signed) James J. Saxon

James J. Saxon
Comptroller of the Currency

JUN 25 1984

In your letter of May 18, 1984, you made three inquiries.

First, you ask the maximum interest rate that a National Bank may charge in certain specified states. Subject to certain exceptions it may generally be stated that National Banks in California, Illinois, Wisconsin and Kansas may charge interest at a rate up to ten per centum per annum, while in Illinois the normal maximum rate is seven per per centum per annum.

Secondly, you inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments, credit life insurance, recording fees, documentary stamp are illustrations of charges which are made by some banks which would not properly be characterized as interest.

Thirdly, you requested information as to the formula used by bank examiner to convert charges to rate equivalent for purpose of determining whether the charges are

at an excessive rate. Because of the inter-relation of state laws with Federal laws there is no set formula. The examiner must look at each questioned transaction with the view of uncovering any unlawful practice on the part of the lending institution. In questionable cases the problem is referred to the Law Department of the Office of the Comptroller of the Currency for review.

If you should desire any additional information this Office would be pleased to furnish such information upon request.

Sincerely,

(Signed) James J. Saxon

James J. Saxon
Comptroller of the Currency

OCT 25 1965

This is in reply to your letter of April 23, 1965, and July 22, 1965, referred to this Office by Regional Comptroller Paul Ross and Deputy Regional Comptroller John Burt, respectively, in which you raise certain questions in connection with the interest rates which may be charged by a National Bank on small loans. Your letter of July 22, 1965, contains a copy of the Kansas Consumer Loan Act for our consideration. Your questions are as follows:

1. Is the ___ National Bank permitted to charge the rates as outlined in the Kansas Consumer Loan Act without obtaining a license?

2. Is the ___ National Bank permitted to charge a late charge when payments remain past due and unpaid for a period of ten days or more, and if so, what is the maximum amount that can be charged?

3. In the ___ National Bank permitted to charge a fee for an excessive or missing a monthly payment, and if so, what are the limits or charges of this nature?

4. What is the maximum rate of interest which the National Bank may charge on a short term, single payment loans, as is the case of a 30, 60, or 90 day loan in a small amount?

As is stated in paragraph 7310 of the *Comptroller's Manual for National Banks,* A National Bank may charge interest at the maximum rate permitted by applicable state law to any competing state lending institution. Where state law permits a higher rate of interest on specified classes of loans (for example, small loans), a National bank which makes loan at such higher rate is

subject only to such limitations relating to the classification of loans as are material to the determination of a rate of interest. It is noted that K.S.A. 16-404 provides that "(a) person doing business under the authority of . . . the United States relating to banks . . . shall not be required to become a licensee under this act . . . " Accordingly, in reply to your first question, a National Bank in Kansas may, under its existing corporate authority as set forth in paragraph Seventh of 12 U.S.C. 2, and that obtaining a license or further permission from any state or federal authority, charge interest on small loans, or loans within a certain stated amount, at the maximum rate permitted by applicable state law to any competing state lending institution operating under a small loan license.

In reply to your second and third questions, it is settled that state laws relating to interest charges are, by the terms of 12 U.S.C. 85, applicable to loans or discounts made by a National Bank only insofar as they establish the maximum rate of interest which may be lawfully charged (Tiffany v. National Bank of Missouri, 85 U.S. 409). Under the applicable Kansas laws (16-202(4) and (5)) relating to delinquency fees and deferment fees, there is no relationship between such fees and interest charges insofar as the Kansas law establishes a maximum rate of interest which may be lawfully charged. Therefore, a National Bank is not subject to the limitations imposed by Kansas law on charges for deferment, default or extension. However, a National Bank may not cloak usurious exactions under the pretense of making such charges. The amount of these charges is a matter for determination by the bank's board of directors, taking into consideration the amount of the particular loan, the extent to which the

loan is past due or extended, and the expense incurred by the bank as a result of the default or extension.

In reply to your fourth question, the provision of Kansas law applicable to loans of the 30-60-90-day type is K.S.A. 16-202(a), which provides, in pertinent part, that "(t)he parties to any . . . promissory note or other instrument of writing for the forbearance of money may stipulate therein for interest receivable upon the amount of such . . . note, or other instrument of writing, at a rate not to exceed ten percent (10%) per annum unless otherwise specifically authorized by law . . . " Lower maximum interest rates which are provided for in the Kansas Consumer Loan Act, in K.S.A. 16-202(b) and 16-410, are applicable only to installment type loans which provide for periodic payments, where as the 10% limitation of K.S.A. 16-208(2) relates to the maximum rate chargeable by National Banks on single-payment loans under Kansas law.

Sincerely,

(Signed) James J. Saxon

James J. Saxon
Comptroller of the Currency

Nos. 93-1612 and 93-1613

In the Supreme Court of the United States

October Term, 1994

NationsBank of North Carolina

petitioners,

v.

Variable Annuity Life Insurance Company, et al.

Eugene Ludwig, Comptroller of the Currency, et al., petitioners

v.

Variable Annuity Life Insurance Company, et al.,

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL PETITIONERS

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* * *

tation was at least a reasonable one. Having failed to impeach its reasonableness in light of the language and purposes of Section 92 and the remainder of the federal banking laws, the court of appeals erred in substituting its judgment for that of the Comptroller on matters within his expertise and regulatory competence.[19]

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[19] In its opposition to the certiorari petitions in this case, respondent contended (Br. in App. 12) that the Comptroller's determination is not entitled to deference because its [sic] is inconsistent with positions taken in 1978 and 1982. Even revised administrative positions are, of course, entitled to deference. *E.g., Good Samaritan Hosp. v. Shalala*, 113 S. Ct. 2151, 2160-2161 (1993). The letter to which respondent refers, however, "hardly establis[h] an inconsistent policy." *Thomas Jefferson Univ. v. Shalala*, No. 93-120 (June 24, 1994), slip op. 11-12. As we pointed out in our reply brief at the petition stage (at 3-4), the 1978 letter represents informal advice by an agency lawyer, contains no analysis supporting the views expressed, and clearly identifies its conclusions as the personal opinion of its author. See Br. in Opp. 1a-2a. Such a letter would not bind the agency or the recipient or be subject to review by the courts. See *New York Stock Exch. v. Bloom*, 562 F.2d 736, 741 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978); *American Land Title Ass'n v. Clarke*, 743 F. Supp. 491, 494 (W.D. Tex. 1989). It therefore cannot provide a basis for contending that the agency has changed course. *Independent Ins. Agents v. Ludwig*, 997 F.2d 958, 962 (D.C. Cir. 1993). the 1982 letter sets forth a similar informal opinion by a member of the OCC legal staff. See OCC Interpretive Letter No. 241, [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85.405 (Mar. 26, 1982). Moreover, as explained in our reply brief (at 4-5), that letter's discussion of sales of term life insurance does not conflict with the Comptroller's decision in this case concerning annuities.

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a Fleet VISA® Card
with no annual
fee until
February 1992!

Statement of Rates and Fees

Annual percentage rate for purchases and cash advances	17.9%
Variable rate information	None
Grace period for repayment of balances for purchases	You have 25 days to repay your balance before a finance charge on purchases will be imposed. This grace period is only allowed for accounts with no balance on old purchases.
Method of computing the balance for purchases	Average daily balance (including new purchases).
Annual fees	$25 see note
Minimum finance charge	None
Transaction fee for purchases	None
Transaction fee for cash advances	None

Late Payment Fee	$10.00. Not applicable to residents of: CO, IL, IA, KS, LA, ME, MA, MN, OK, PA, SC, WV, WI, WY, AK, NY, VA, IN, ID, NC, MO, NJ, AL, VT.
Over-Limit Fee	$7.50. Not applicable to residents of: AZ, CO, IL, IA, KS, LA, ME, MN, MS, OK, PA, SC, WV, WI, WY, AK, IN, MI, KY, MD, NC, MO, NJ, NY, AL.

Note: $12 In ME, MS, LA; $15 In NJ, PA, AL; $20 In IL, KY, NC.

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Please allow approximately 4 weeks for processing.

All information on this application is true and correct to the best of my/our knowledge and no material information has been omitted. I/we authorize the bank to gather credit information about me/us and to give information about the account to others as permitted by law. This application remains the property of the bank. I/we agree to the terms and conditions governing VISA Accounts and request that credit cards be sent to me/us and any user listed above. I/we understand that I/we must pay the bank any expenses it incurs in collecting what I/we

owe it, to the extent permitted by law, and that this includes reasonable attorney's fees and court costs. Further, I/we understand that any bank card I/we am/are issued is the property of Fleet National Bank, and may be revoked or repossessed at any time and must be returned upon request.

PROCESSED BY

MAR 30 1995
DISCLOSURE
INCORPORATED

Commission file number 1-11758.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1994

Dean Witter, Discover & Co.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-3145972 (IRS Employer Identification No.)
Two World Trade Center New York, New York (Address of principal executive offices)	10048 (Zip Code)

Registrant's telephone number, including area code:
(212) 392-2222

Securities registered pursuant to Section 12(b)
of the Act:

Title of each class	Name of exchange on which registered
Common Stock – $.01 per value	New York State Exchange Pacific Stock Exchange

Securities registered pursuant to Section 12(g)
of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceeding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of March 24, 1995, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $6,989,284,053. For purposes of this information, the outstanding shares of Common Stock owned by the directors and executive officers of the Company were deemed to be held by affiliates, and the Dean Witter, Discover & Co. START Plan (Savings Today Affords Retirement Tomorrow), the SPS Transaction Services, Inc. START Plan (Savings Today Affords Retirement Tomorrow), The Savings and Profit Sharing Fund of

Sears Employees, the Dean Witter Reynolds Inc. Account Executive Productivity Compensation Plan, the Dean Witter Reynolds Inc. Branch Manager Compensation Plan and the Dean Witter, Discover & Co. Employee Stock Purchase Plan were deemed to be non-affiliates.

APPLICABLE ONLY TO CORPORATE REGISTRANTS: Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date.

170,150,603 Shares of Common Stock, $.01 per value, as of March 24, 1995

DOCUMENTS INCORPORATED BY REFERENCE

1. Dean Witter, Discover & Co. 1994 Annual Report to Shareholders (for the fiscal year ended December 31, 1994). Certain information contained in this document is incorporated by reference in Parts I and II.

2. Dean Witter, Discover & Co. Proxy Statement for its 1995 Annual Meeting of Stockholders (dated March 28, 1995). Certain information contained in this document is incorporated by reference in Part III.

* * *

Consolidated Statements of Income

(in millions, except per share data)

Year Ended December 31,	1994	1993	1992
Asset management and administration fees	$ 973.0	$ 838.0	$ 679.2
Merchant and Cardmember fees	940.0	770.4	641.1
Commissions	874.3	904.0	721.9
Servicing fees	586.4	533.2	412.8
Principal transactions	421.9	405.1	433.4
Investment banking	197.9	394.9	254.6
Other	101.9	66.8	65.4
Total non-interest revenues	4,095.4	3,912.4	3,208.4
Interest revenue	2,507.2	1,909.2	1,975.1
Interest expense	1,048.5	815.3	965.8
Net interest income	1,458.7	1,093.9	1,009.3
Provision for losses on receivables	548.4	457.6	484.1
Net credit income	910.3	636.3	525.2
Net operating revenues	5,005.7	4,548.7	3,733.6
Employee compensation and benefits	1,764.2	1,703.9	1,464.1
Marketing and business development	607.2	470.4	397.2
Information processing and communications	596.7	545.9	472.9
Facilities and equipment	228.1	217.8	213.8
Other	594.9	614.5	514.8
Total non-interest expenses	3,791.1	3,552.5	3,062.8
Gain on sale of subsidiary stock	-	-	32.1
Income before income taxes and cumulative effect of accounting change	1,214.6	996.2	702.9
Income tax expense	473.7	392.6	263.8
Income before cumulative effect of accounting change	740.9	603.6	439.1
Cumulative effect of change in accounting for postretirement benefits other than pensions, net of income taxes	-	-	28.6
Net income	$ 740.9	$ 603.6	$ 410.5
Earnings per common share			
Net income	$ 4.35	$ 3.66	-
Average common shares outstanding	170.5	164.8	-
Pro forma earnings per common share			
Income before cumulative effect of accounting change		$ 3.54	$ 2.58
Cumulative effect of accounting change		-	0.17
Pro forma net income		$ 3.54	$ 2.41
Pro forma common shares outstanding		170.5	170.5

See notes to consolidated financial statements.

**IN THE SUPREME COURT
OF THE STATE OF NEW JERSEY**
Docket No. C-11 September Term 1994, 38,817

MARC SHERMAN,
On Behalf of Himself and
All Others Similarly Situated,

Plaintiff/Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant/Respondent.

**BRIEF OF AMICUS CURIAE COMPTROLLER
OF THE CURRENCY IN SUPPORT OF
RESPONDENT AND DEFENDANT**

FROM THE OPINION OF THE SUPERIOR COURT
OF NEW JERSEY, APPELLATE DIVISION

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COMPTROLLER
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IN THE SUPREME COURT OF THE STATE OF NEW JERSEY

Docket No. C-11 September Term 1994, 38,817

MARC SHERMAN,
On Behalf of Himself and
All Others Similarly Situated,

Plaintiff/Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant/Respondent.

BRIEF OF AMICUS CURIAE COMPTROLLER OF THE CURRENCY IN SUPPORT OF RESPONDENT AND DEFENDANT

INTRODUCTION

The Office of the Comptroller of the Currency ("OCC") is a bureau within the Department of Treasury charged with the administration of the National Bank Act, 12 U.S.C. §§ 1 *et seq*. The OCC has broad authority over the chartering, supervision, and regulation of almost every aspect of the affairs of, banks organized under the National Bank Act, including the power to determine whether a bank's activities are permissible under national banking laws. *See Independent Bankers Ass'n of Am. v. Heimann*, 613 F.2d 1164, 1168 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980); *First Nat'l Bank v. Smith*, 610 F.2d 1258, 1264 (5th Cir. 1980). Citibank (South Dakota), N.A., is a national bank chartered and supervised by the OCC.

In connection with its supervision of national banks pursuant to its responsibilities under the National Bank Act, the OCC has issued several interpretations of Section 30 of the National Bank Act, codified at 12 U.S.C. § 85 (hereinafter "Section 85"). In addressing the issue presented in this case – whether Section 85 governs late payment fees that are charged by a national bank to its credit card customers in states other than the state in which the bank is located – the OCC has repeatedly held that credit card late payment charges are within the scope of charges covered by Section 85, which governs the interest rate that national banks may charge in connection with loans to their customers wherever the customer is located. This interpretation of Section 85 is entitled to judicial deference. *See Clarke v. Securities Industry Ass'n*, 479 U.S. 388, 403-404 (1987).[1]

National banks, such as Defendant/Respondent in this action, have relied on the OCC's interpretation of Section 85 and have structured their lending programs to conform to these longstanding interpretations. Indeed, national banks lend millions of dollars of credit every day in reliance on the lending authority conferred by Section

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[1] " 'It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of the banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.' " *Clarke v. Securities Industry Ass'n*, 479 U.S. 388, 403-404 (1987) (quoting *Investment Company Institute v. Camp*, 401 U.S. 617, 626-627 (1971)); *accord NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*, 63 U.S.L.W. 4076, 4077 (Jan. 18, 1995).

85 and the laws of their home states. Section 85 provides national banks predictability about their lending operations by setting a uniform standard for determining the charges that may be assessed in connection with those activities. This predictability and uniformity is critical to interstate lending. If the permissible charges for a credit card transaction were determined with reference to the home state of the borrower, the flow of interstate lending would be severely undermined. But more importantly, such a result would be contrary to the plain meaning and purpose of Section 85.

COUNTERSTATEMENT OF THE CASE

The Comptroller of the Currency adopts the Counterstatement of the Case set forth in the brief filed by Defendant/Respondent Citibank (South Dakota), N.A. (hereinafter "Citibank").

RESTATEMENT OF THE ISSUE PRESENTED FOR REVIEW

The Comptroller of the Currency adopts the Restatement of the Issue Presented for Review set forth in the brief filed by Citibank.

ARGUMENT

I. SECTION 85 MANDATES THAT NATIONAL BANKS MAY CHARGE INTEREST FOR EXTENSIONS OF CREDIT AT THE RATE PERMITTED UNDER STATE LAW TO COMPETING LENDERS.

Section 85 provides that national banks may "take, receive, reserve, and charge on any loan or discount made . . . interest at the rate allowed by the laws of the State . . . where the bank is located. . . . " The Supreme Court has explained that this provision "allows [national] banks to charge such interest as state banks may charge, and more, if by the laws of the state more may be charged by natural persons." *Tiffany v. Nat'l Bank of the State of Missouri*, 85 U.S. (18 Wall) 862, 864 (hereinafter "*Tiffany*"). Congress' purpose in enacting Section 85 was to give national banks "at least equal advantages" in their competition with state chartered lenders. *Id.* at 863. Thus, the Supreme Court viewed Section 85 as "an enabling statute, not a restraining one, except so far as it fixes a maximum rate" that national banks may charge as interest by reference to state law. *Id.* By granting national banks the ability to charge interest at the most favorable rate allowed to competing lenders – "most favored lender" status – Congress ensured that the states could not adopt unfriendly legislation that "might make [national banks'] existence in the state impossible." *Tiffany* at 864; *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 314 n.26 (citing *Tiffany*).[2]

[2] This well-settled judicial interpretation of Section 85 is reflected in OCC Interpretive Ruling 7.7310(a), originally published in 1963, which continues to provide that a "national

Interpretations of Section 85 are made with this purpose in mind.

II. NATIONAL BANKS MAY CHARGE THE SAME INTEREST PERMISSIBLE UNDER SECTION 85 TO INTRA-STATE AND INTERSTATE CUSTOMERS.

Section 85 allows national banks to charge whatever interest is permissible to state-chartered lenders. Moreover, the Supreme Court has explained that national banks may charge their credit card customers the interest rates permitted under Section 85 without regard to where the bank's customer resides or the transaction takes place. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). In short, by application of Section 85, a national bank may "export" its home state interest rates when extending credit to borrowers residing in foreign states.

In *Marquette*, the Court rejected the argument that the inequalities that arise when a national bank applies the interest rate of its home state in its dealings with residents of a foreign state violated the intent of Congress when enacting Section 85, or that impairment of the

bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. . . . " The most favored lender doctrine also is reflected in many individual OCC rulings with regard to Section 85. *See, e.g.*, Letter from William P. Bowden, Jr., OCC Chief Counsel (Feb. 4, 1992); Letter from Robert B. Serino, OCC Deputy Chief Counsel (Policy) (Aug. 11, 1988) *reprinted in* [1988 – 1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 (OCC Interp. Letter No. 452).

ability of the states to enact laws governing usury warranted limiting the application of Section 85 to transactions within the national bank's home state. *Id.* at 313-315, 318. To the extent that a foreign state's laws attempt to limit a national bank's ability to charge interest that is authorized under Section 85, those state laws are preempted. *Id.* at 318 n.31.

III. THE MEANING OF "INTEREST" WITHIN SECTION 85 IS A MATTER OF FEDERAL LAW.

Section 85 does not define interest. Moreover, Section 85 specifically requires reference to state law to determine the limits on the interest that national banks may charge. Nevertheless, federal rather than state law determines what is interest for purposes of Section 85. *See, e.g.*, *Evans v. Nat'l Bank of Savannah*, 251 U.S. 108, 114 (1919) (federal law defines when charges by a national bank are usurious, "referring to state law only to determine the maximum permitted rate" that may be charged on the loan).[3]

Even when a federal statute looks to state law to describe permissible activities of national banks, the Supreme Court has stated that it is necessary to consider the policy behind the federal statute to determine whether a federal or state law definition controls the terms of the federal statute. For example, in *First National*

[3] In its opinion letters discussing Section 85, the OCC has described in various ways the role of state law in the determination of what charges are permissible under the federal statute. While some letters overstate the role of state law, it is clear that the boundaries of Section 85 are a matter of federal law.

Bank in Plant City v. Dickinson, 396 U.S. 122, 130-134 (1969) (hereinafter "*Plant City*"), the Supreme Court was interpreting 12 U.S.C. § 36, the federal statute governing branching by national banks. The Court noted that "the federal statute . . . incorporated by reference the limitations which state law places on branch banking activities by state banks." *Id.* at 131. However, the Court rejected the contention that the statutory reference to state law meant that state law definitions controlled the federal statute, concluding its analysis by explaining that the definition of a term in a federal statute "must not be given a restrictive interpretation which would frustrate . . . congressional intent." *Id.* at 134. The same analysis should be applied when defining "interest" for purposes of Section 85. If adoption of a state law definition would frustrate the congressional intent in enacting Section 85, then a federal definition is required.[4]

In order to achieve the purpose of Section 85, to protect national banks from discriminatory state laws involving the interest they may charge, interest must be defined by federal law. If the states were able to determine what charges are interest for purposes of Section 85, then it is arguable that they could deny national banks the most favored lender status granted by Congress. For example, states might be able to define particular charges as something other than interest and, exercising their

[4] As in this case, *Plant City* involved differing interpretations of the definition of a term in a federal statute that made reference to state law. However, the statute at issue in *Plant City* contained a statutory definition of branch bank that aided the Court's analysis.

police powers, prohibit contracts within the state from including those charges, except when the contract involves a favored state-chartered lending institution. This is precisely the type of economic discrimination that Congress intended to prevent when it enacted Section 85. *See Tiffany*, 85 U.S. at 863. Therefore, even though Congress requires reference to state law to determine what interest a national bank located in the state may charge, what constitutes interest for purposes of Section 85 must be defined by federal law. As the Supreme Court observed in its analysis of the definition of branch in *Plant City*: "[T]o allow the States to define the content of the term 'branch' would make them the sole judges of their own powers. Congress did not intend such an improbable result. . . . " 396 U.S. 133-134. It is equally improbable that Congress intended the states to define interest for purposes of Section 85.

IV. THE COURTS AND THE OCC HAVE CONSISTENTLY CONCLUDED THAT PAYMENTS TO COMPENSATE A CREDITOR FOR EXTENDING CREDIT TO THE BORROWER OR TO COMPENSATE THE CREDITOR FOR THE BORROWER'S DEFAULT UNDER THE CREDIT AGREEMENT ARE GOVERNED BY SECTION 85.

Neither Section 85 nor regulatory definitions restrict the term "interest" to charges in any specific form.[5] Consistent with the Congressional purpose of preventing

[5] Although Section 85 does not define "interest", the term has been defined as "a charge for borrowed money[,] generally a percentage of the amount borrowed." *See Webster's Ninth New Collegiate Dictionary* 630 (1989). However, this does not mean

states from discriminating against national banks in the compensation they receive as interest for extensions of credit, the vast majority of judicial opinions interpreting Section 85 have concluded that various forms of charges fall within the scope of Section 85. *See, e.g., Union Nat'l Bank v. Louisville, New Albany, & Chicago Ry. Co.*, 163 U.S. 325 (1896) (commission); *American Timber & Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982) (compensating-balance requirement); *Fisher v. First Nat'l Bank*, 548 F.2d 255, 258-261 (8th Cir. 1977) (flat fees); *McAdoo v. Union Nat'l Bank*, 535 F.2d 1050 (8th Cir. 1976) (compensating-balance requirement); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 863 (6th Cir. 1972) (loan closing costs); *Panos v. Smith*, 116 F.2d 445 (6th Cir. 1940) (mortgage taxes and recording fees); *Landau v. Chase Manhattan Bank, N.A.*, 367 F. Supp. 992, 999 (S.D.N.Y. 1973) (service and maintenance charges); *In re Gerber's Estate*, 337 Pa. 108, 9 A.2d 438 (1939) (brokerage fees); *First Nat'l Bank v. Phares*, 70 Okla. 255, 174 P. 519 (1918) (transaction costs); *Northampton Nat'l Bank v. Attorney General*, 8 Mass. App. Ct. 809, 397 N.E.2d 1149 (1979) (annual fee).

Interpretations by the OCC over a period of decades are in accord with the judicial interpretations of Section 85. The OCC has long had in place a regulation that explicitly recognizes the application of Section 85 to all

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that interest must always be expressed as a percentage. Moreover, as discussed *infra*, to adopt a narrow interpretation of Section 85 that excludes from interest any charge except those expressed as numerical percentage charges or non-contingent charges would destroy the most favored lender status of national banks and, therefore, would be contrary to Section 85.

aspects of loan compensation that are "material to the determination of the interest rate." 12 C.F.R. § 7.7310(a).[6] The OCC also has issued interpretive letters that have concluded that various charges are governed by Section 85. *See, e.g.*, Letter from William P. Bowden, Jr., OCC Chief Counsel (Feb. 4, 1992) (credit card fees including late fees); Letter from Robert B. Serino, Deputy Chief Counsel (Policy) (Aug. 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 (OCC Interp. Letter No. 452) (credit card late charges, returned check charges, and cash advance charges); Letter from Kenneth W. Leaf, OCC Chief National Bank Examiner 2 (Feb. 13, 1974) (Section 85 governs " 'all reasonable and necessary charges incurred in connection with the making, closing, disbursing, expending, readjusting or renewing of . . . loans' " (citation omitted)); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 10, 1961) (service charges); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 1, 1956) (fees or expenses); Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) (delinquency charges); Letter from R.B. McCandless, Deputy Comptroller of the Currency (Sept. 3, 1947) (service charges); Letter

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[6] Interpretive Ruling 7.7310 provides in pertinent part:

> A national bank may charge interest at the maximum rate permitted by State law to any competing state-chartered or licensed lending institution. If State law permits a higher interest rate on a specific class of loan, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate.

from J.L. Robertson, deputy Comptroller of the Currency (Feb. 4, 1946) (set-up charges, collection charges).[7] These letters have consistently[8] permitted national banks to charge fees that are necessary to compensate the banks for extending credit to their borrowers and to compensate the banks for the borrowers' default under the credit agreement, subject to state law limitations on these

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[7] Although the results reached by the OCC on the permissibility of the charges are consistent among the letters and consistent with judicial interpretations of Section 85, analytical variation occurred in some interpretations over the question of whether state law definitions of "interest" are automatically incorporated into Section 85. As discussed above, although Section 85 looks to state law to identify the maximum interest that national banks may charge, federal law defines what is interest for purposes of Section 85.

[8] In 1964, the OCC issued a letter to a national bank stating that charges for late payments "are illustrations of charges which are made by some banks which would not properly be characterized as interest." Letter from James J. Saxon, Comptroller of the Currency, dated June 25, 1964. It is not clear that the quoted passage was issued in the context of a determination of whether the term "interest" used in Section 85 includes late charges nor does the context of the letter clearly indicate that it is intended as a ruling of the agency with respect to that question.

In a letter concluding that appraisal fees were not governed by Section 85, a staff member of the OCC in passing expressed the view that late charges "appear not to determine the numerical rate of interest to be charged." *See* Letter from Peter Liebesman, Assistant Director, Bank Operations and Assets Division (February 26, 1993). However, the issue of late charges was not the subject of that letter and the letter does not represent the OCC's position on this issue. Letter from Wallace S. Nathan, Director, Bank Operations and Assets Division (May 23, 1994).

charges for state chartered lenders where the national bank is located.[9] Consistent with the judicial interpretations of Section 85, the charges approved in these letters have included flat charges and contingent charges.[10]

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[9] Although there is authority that the definition of interest at the time of enactment of the National Bank Act included late payment fees, *see, e.g., Brown v. Hiatts*, 82 U.S. (15 Wall) 177, 185 (1873) ("compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention"), the OCC is not persuaded that the definition of interest for purposes of Section 85 is limited to forms of payments that existed in 1864. As the Supreme Court explained in *Plant City*: "The policy of competitive equality is . . . firmly embedded in the statutes governing the national banking system. The mechanism of referring to state law is simply one designed to implement that congressional intent and build into the federal statute a self-executing provision to accommodate to changes in state regulation." 396 U.S. at 133. To give full effect to the most favored lender status of national banks, Section 85 must be able to reflect changes in state regulation of the permissible charges for extensions of credit in response to the changing economic conditions and requirements of the country.

[10] The majority opinion in *Mazaika v. Bank One*, (Pa. Super. Ct. filed Dec. 14, 1994), 1994 Pa. Super. Lexis 3612, concluded that Section 85 does not cover charges that are not assessed on a percentage basis. This conclusion is contrary to the decisions of all other courts that have considered the issue, and the analysis in that opinion would destroy the most favored lender status that Congress granted national banks by permitting states to denote contingent charges and flat fees as something other than "interest" permitted by Section 85.

This very situation is illustrated in *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855. In that case, state law permitted savings associations to collect closing costs in addition to the maximum statutory interest rate for certain types of loans. State legislation also provided that the closing

A. THE COURTS AND THE OCC HAVE CONSISTENTLY INTERPRETED SECTION 85 TO GOVERN CREDIT CARD LATE PAYMENT CHARGES.

Every court that has considered the issue has concluded that late-payment fees are governed by 12 U.S.C. § 85, except the Superior Court of Pennsylvania.[11] *See, e.g., Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 829-831 (1st Cir. 1992), *cert. denied*, 61 U.S.L.W. 3478 (Jan. 11, 1993); *Tikkanen v. Citibank (S.D.), N.A.*, 801 F. Supp. 270 (D. Minn. 1992) ("[L]ate fees . . . are interest within the meaning of section 85"); *Sherman v. Citibank (S.D.), N.A.*, 640 A.2d 325 (N.J.Super. Ct. App. Div. 1994) (late-payment fees) *cert. granted*, Oct. 24, 1994; *Copeland v. MBNA*

costs would be in addition to interest authorized by law and would not be deemed to be a part of interest for purposes of state law. A borrower sued the national bank for usury under 12 U.S.C. § 86 when the bank charged for closing costs in addition to the maximum numerical interest rate allowed under state law. In affirming the trial court's dismissal of plaintiff's action, the Sixth Circuit Court of Appeals quoted with approval the trial court's conclusion that to construe Section 85 as not permitting a national bank to collect closing costs that state law permitted savings associations to collect "would place a national bank in a competitively inferior position not contemplated by the federal statute." *Id.* at 864.

[11] In *Mazaika v. Bank One, supra*, an *en banc* panel of the Superior Court of Pennsylvania concluded that while Section 85 preempted state laws that regulate the interest rate charged by national banks, the service fees charged by Bank One, including a late payment fee, were not interest under Section 85. This case was wrongly decided, with the majority opinion erroneously concluding that only numerical percentage-based charges could qualify as interest for purposes of Section 85.

America, N.A., 833 P.2d 564 (Colo. Ct. App. 1994), *cert. granted*, 1994 Colo. Lexis 808 (Oct. 24, 1994).[12] Underlying the reasoning in each of these cases is judicial recognition of the necessity of including these charges in interest in order to give effect to Congress' mandate in Section 85 that prohibits discrimination against national banks in the interest that they may charge for extensions of credit.

The OCC has long interpreted Section 85 as covering late payment charges that are authorized by the law of the state where a national bank is located. *See* Letter from L.A. Jennings, *supra* (statute providing for late payment charges at a specified numerical percentage of the amount of the late installment). Moreover, the OCC has concluded that credit card late payment charges are governed by section 85 in interpretive letters issued by its Chief Counsel, William P. Bowden, Jr., and Deputy Chief Counsel, Robert B. Serino. *See* Letter from Robert B. Serino, *supra*; Letter from William P. Bowden, Jr., *supra*. *See also* n.8, *supra*. In the Serino and Bowden letters, the OCC analyzed the cases that had interpreted Section 85 and determined that credit card late payment charges were material to the determination of the interest rate for these types of loans and, therefore, within the coverage of Section 85, even though state law did not specify a limit

[12] Cases during the period prior to enactment of the National Bank Act recognized late payment charges on loans as interest regardless of whether they were flat fees or a higher periodic percent rate for payment after the loan was due. *See, e.g., Wernwag v. Mothershead*, 3 Blackf 401, 402 (Ind. 1834) (flat, per week charge); *Daggett v. Pratt*, 15 Mass. 177 (1818) (increased rate of interest); *Wilkinson (Wilkerson) v. Daniels*, 1 Greene 179, 188 (Iowa 1848).

on these charges. *See Daggs v. Phoenix National Bank*, 177 U.S. 549 (1900) (holding that an Arizona statute which allowed lenders and borrowers to contract for any rate of interest also allowed national banks to charge any rate of interest); *Hiatt v. San Francisco National Bank*, 361 F.2d 504, 507 (9th Cir. 1966) (holding that the silence of the California legislature regarding the maximum allowable rate of interest permitted national banks to charge whatever interest rate was agreed between the parties).

The late payment charges involved in this appeal are intended to compensate the bank for the borrower's default under the credit agreement. Numerous courts and long-standing interpretations of the OCC have concluded that late payment charges are within the scope of charges that national banks may collect under Section 85 when state law allows competing lenders to collect them. This Court should reach the same conclusion.

B. OCC'S INTERPRETATION OF THE NATIONAL BANK ACT IS ENTITLED TO DEFERENCE.

The OCC's interpretations of the statutes that the Congress has placed under its oversight are to be accorded substantial deference. As the Supreme Court recently observed:

> Under the formulation now familiar, when we confront an expert administrator's statutory exposition, we inquire first whether "the intent of Congress is clear" as to "the precise question at issue." *Chevron U.S.A. Inc., v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). If so, "that is the end of the matter." *Ibid.* But "if the statute is silent or ambiguous with

> respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.*, at 843. If the administrator's reading fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment "controlling weight." *Id.*, at 844

Nationsbank of North Carolina, N.A. v. Variable Annuity Life Insurance Co., 63 U.S.L.W. 4076, 4077 (January 18, 1995). *See also Clarke v. Securities Industry Ass'n, supra*, 479 U.S. 403-404 (1987).

While courts have held that interpretive regulations and opinion letters are not binding upon the courts, they are entitled to substantial deference in cases, such as this, in which the agency has been vested with important interpretive powers in a complex or technical field. *See, e.g., Bright v. Ball Memorial Hosp. Ass'n*, 616 F.2d 328, 333 n.1 (7th Cir. 1980); *Charles v. Krauss Co.*, 572 F.2d 544, 547-48 (5th Cir. 1978). Indeed, the Supreme Court has on occasion afforded deference to an agency position expressed in an *amicus curiae* brief. *See Basic, Inc. v. Levison*, 485 U.S. 224, 239 n.1 (1988). *See also Trustees of Iron Workers Local 1473 Pension Trust v. Allied Products Corp.*, 872 F.2d 208, 210 n.2 (7th Cir. 1989) (*amicus* brief of agency entitled to deference because of agency's responsibility to enforce statute), *cert. denied*, 493 U.S. 847 (1989).

In this case, the OCC has consistently interpreted Section 85 to permit national banks to receive interest in the form of charges other than a numerical interest rate and has specifically concluded that credit card late payment charges are governed by Section 85. Virtually every

court that has considered the issue has reached the same conclusion as the OCC. This consistent interpretation, confirmed by numerous judicial decisions, is entitled to great weight.

CONCLUSION

For the reasons stated above, the Comptroller of the Currency respectfully requests that this Court affirm the decision of the Court of Appeal.

Respectfully submitted,

/s/ L. Robert Griffin
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,
v.

CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On Writ of Certiorari to the California Supreme Court

BRIEF OF THE STATES OF COLORADO, DELAWARE, GEORGIA, ILLINOIS, MONTANA, NEBRASKA, NEVADA, NEW YORK, OHIO, SOUTH DAKOTA, AND UTAH, THE COMMONWEALTHS OF PENNSYLVANIA AND VIRGINIA, THE ARIZONA STATE BANKING DEPARTMENT, AND THE LOUISIANA OFFICE OF FINANCIAL INSTITUTIONS, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici curiae, the States of Colorado, Delaware, Georgia, Illinois, Montana, Nebraska, Nevada, New York, Ohio, South Dakota, and Utah, and the Commonwealths of Pennsylvania and Virginia, through their respective Attorneys General, the Arizona State Banking Department, through its Superintendent, and the State of Louisiana Office of Financial Institutions, through its Commissioner (the "States"), support the position of respondent Citibank (South Dakota), N.A. ("Citibank") in urging affirmance of the judgment of the California Supreme Court.[1] The States believe that the California Supreme Court correctly held that the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, includes late payment fees charged by national banks on credit card balances and other loans. The decision in this case will necessarily address at least two interests of great importance to the States and our residents: consumer welfare and the safety and soundness of banks.

The States have an important interest in promoting consumer welfare. Our consumers depend on credit cards every day, and they benefit from policies that promote broad access to credit, low credit card costs, and the ability to choose freely from the broadest possible range of different packages of rates and charges that are offered by credit card issuers.

The States also have an important interest in promoting the safety and soundness of banks located within our borders, and in ensuring predictability in the banking industry. Events of recent years have demonstrated that when banks sustain large and unexpected losses (such as those that they potentially face in this lawsuit and similar suits across the country), the well-being of the general

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[1] Pursuant to Court Rule 37.3, this brief is filed with the consent of the parties. Letters of consent have been filed with the Clerk's Office.

economy may suffer, to the detriment of all of our residents.

Affirmance of the judgment of the California Supreme Court would further the interests of our consumers and would also protect the safety and soundness of banks in our States. Reversal, however, would have precisely the opposite, profound effects. Consumers in our States and elsewhere would be significantly injured by decreased access to credit, higher costs of credit, and fewer options in the credit card market. In addition, banks in our States and throughout the country would be exposed to the potential of staggering damage awards that could threaten the safety and soundness of the banking system and, with it, the health of the entire economy. Reversal would also upset the settled expectations that support the smooth functioning of the national banking system that has served the country well for decades.

The States endorse the arguments made by respondent Citibank. Those arguments will not be repeated here. Rather, this brief focuses on the practical significance of this case to the States, to our consumers, and to the banks located within our borders. The States believe that our distinct perspective on the issues presented will materially assist the Court in resolving this case properly.

SUMMARY OF ARGUMENT

This is not, as petitioner and her *amici* suggest, a conventional preemption case. Section 85 effectively operates in the context of this case as a choice of law rule. In interstate credit card transactions, there is always an inherent conflict of laws problem. The home state of the bank, the state of the borrower's residence, and even the state in which the purchase or cash advance is made, each has a connection with, and potentially an interest in, the proper legal standards that govern the transaction. Section 85 resolves one source of conflict by providing, as a matter of federal law, a clear and uniform rule that the

propriety of the "interest" charged by a bank is determined by the substantive law of the bank's home state.

Consequently, although this case has enormous practical significance to all segments of the economy of our States, at bottom it presents nothing more than a straightforward quesion of statutory interpretation of the meaning of the term "interest" in section 85 of the National Bank Act. Based upon the widespread use of that term in nineteenth century judicial opinions and today, it is clear that "interest," as used by Congress in 1864, includes late charges. However, even assuming for the sake of argument that the term, at least viewed in isolation, were potentially ambiguous, the construction of section 85 reached by the California Supreme Court (and the vast majority of other courts) should nonetheless be affirmed. Under settled rules of statutory construction, this Court should look to whether the Office of the Comptroller of the Currency ("OCC")—the federal agency charged with administering the National Bank Act—has issued an authoritative interpretation of the meaning of this language. For years, the OCC has in letter rulings expressed the view that the term "interest" in section 85 includes late fees. More recently, the OCC promulgated a final rule, following a notice and comment period, formalizing its interpretation of section 85. The Court should defer to this reasonable and long-standing construction of the relevant language in section 85.

There are particularly strong reasons for according deference to the OCC's interpretation of the term "interest" in section 85. Bank regulators in our States rely upon and obtain substantial guidance from the interpretations of the National Bank Act and other federal banking laws issued by the OCC, the FDIC, and other federal regulatory agencies. Moreover, in reliance upon the OCC's publicly stated position, banks in our States have loaned literally hundreds of billions of dollars to consumers across the country. In interpreting a potentially ambiguous stat-

ute, great weight should be accorded to those reliance interests. Given the amounts at stake in this case, accepting petitioner's argument would have a potentially devastating effect on banks in our States. That harm to the banking industry could, in turn, have a profoundly harmful effect on the entire economy of each of our States, on our businesses, and on our consumers.

In addition, construing "interest" in section 85 to include late fees promotes consumer welfare. Consumers benefit from broad access to credit, lower credit costs, and above all the ability to choose from the broadest possible range of competing credit cards in the marketplace. The conclusion reached by the California Supreme Court furthers those interests. Affirmance would enable consumers in our States to continue to choose from a broad array of credit cards, some of which will be offered by banks in states with little regulation and others of which will be offered by banks in states with greater regulation. The Federal Truth In Lending Act, 15 U.S.C. § 1601 *et seq.*, as well as state disclosure laws and antifraud protections, ensure that consumers throughout the country will have access to the competitive information necessary for them to make informed choices as to what type of credit arrangement best suits their needs.

Finally, affirmance of the judgment of the California Supreme Court would protect the traditional prerogative of the States to set the terms upon which banks located within our borders may lend money. In stark contrast, our States have comparatively little interest in regulating the terms of a transaction in which our residents voluntarily have made the choice to borrow money from a national bank in *another* state, leaving behind the rate limitations of our States. Because section 85 as interpreted by the OCC and the California Supreme Court implements this basic balancing of the relevant interests of the States, the judgment of the California Supreme Court should be affirmed.

ARGUMENT

I. SECTION 85 RECOGNIZES THE CENTRALITY OF STATE LAW IN BANKING REGULATION.

In our country's dual system of banking, banks have historically been regulated by their chartering authority—national banks by the federal government, and state banks by the state governments that charter them. See Emmanuel N. Roussakis, *Commercial Banking in an Era of Deregulation* 60 (2d ed. 1989); Kenneth E. Scott, *The Dual Banking System*, 30 Stan. L. Rev. 1, 5 (1977). This structure of regulation and oversight has applied generally to banks regardless of whether the banks are engaged in intrastate or interstate transactions.

Section 85 of the National Bank Act, 12 U.S.C. § 85, provides that national banks may charge "interest at the rate allowed by the laws of the State . . . *where the bank is located*" (emphasis added). Thus, when a national bank makes a loan (intrastate or interstate), the interest charges that it may assess are determined by the law of the bank's home state. The location of the borrower's residence—whether next-door to the bank, in the same state as the bank, in a different state, or even in a different country—is irrelevant. All customers who borrow from a particular national bank, therefore, are treated the same, regardless of their state of residence.[2]

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[2] Section 85 of the National Bank Act applies to national banks, such as respondent Citibank. In addition, virtually all state-chartered banks are federally insured, and federally insured state banks are subject to section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), 12 U.S.C. § 1831d, which was modeled on 12 U.S.C. § 85. *See* 12 U.S.C. § 1831d(a) (stating, in pertinent part, that a federally insured state bank may charge interest "at the rate allowed by the laws of the State, territory, or district where the bank is located"). Similar statutory provisions apply to all federally chartered and federally insured state-chartered saving associations, 12 U.S.C. § 1463(g)(1), and all federally chartered and federally insured state-chartered credit unions, 12 U.S.C. § 1785(g)(1). As a result,

A. Section 85 Provides A Uniform National Choice Of Law Rule For Interstate Loans.

This is not, as petitioner and her *amici* contend, a conventional preemption case. The effect of section 85 in this case is *not* to displace substantive state law with substantive federal law. Rather, section 85 operates in this context as a choice of law statute. Section 85, in effect, provides a uniform national choice of law rule for interstate loans. Thus, rather than arrogating power to the federal government to impose special federal rules, section 85 takes a different approach that acknowledges the centrality of state concerns and state law, and resolves what might otherwise be complex questions as to which state's law is applicable to a particular interstate loan.

In interstate bank loans (including credit card loans), there are always at least two states potentially interested in the transaction, namely the bank's home state and the borrower's home state.[3] In the absence of section 85, the roles of the law of the bank's home state and the borrower's home state would have to be resolved according to general choice of law principles. See, *e.g.*, Restatement (Second) of Conflict of Laws §§ 188, 195 (1971). Because the application of conflict of laws principles all too often varies with the eye of the beholder, reliance upon those principles would ensure disuniformity in the

the Court's construction of section 85 in this case will directly affect almost all financial institutions in the country.

[3] A third state, the state in which the credit card purchase or cash advance is made, may also have an interest in the transaction. *See* William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 Utah L. Rev. 1009, 1024 & n.50 (1995). As a result, even a relatively simple series of transactions—in which, for example, a California resident makes two telephone calls from home and, with a credit card issued by a bank in Ohio, purchases an airline ticket (on a carrier with its main office in Texas) and makes a reservation in a hotel (in a chain with its main office in Illinois) for a ski holiday in Utah—has the potential for raising difficult and complex conflict of laws issues.

law. In such a situation, the courts would routinely be called upon to resolve those conflicts.

Section 85 resolves that problem for loans made by national banks. Section 85 states, in plain terms, that a national bank may charge on its loans "interest at the rate allowed by the laws of the State . . . *where the bank is located*" (emphasis added). Thus, section 85 effectively provides a uniform national choice of law rule. As a matter of federal law, the law of the bank's home state determines the interest charges that a national bank may assess on all of its loans, both intrastate and interstate.[4]

In enacting section 85, Congress sought to preserve the already established prerogatives of the states to determine the interest that banks located within their borders could charge. Section 85 recognizes the historic importance of substantive *state law* in determining permissible interest charges. Ascertaining which lending charges constitute "interest" under section 85 is a matter of federal law. Once that determination is made, however, the substantive law of the bank's home state determines whether the bank's "interest" charges are permissible.

Of course, Congress was not required to preserve the historic prerogatives of the states. In the exercise of its plenary authority over interstate commerce, Congress could have enacted a standard preemption statute that imposed a single, uniform limit on lending rates for national banks across the country and displaced all state law. Indeed, the House of Representatives originally approved such a preemption provision, imposing a uniform maximum interest rate of seven percent for all loans (intrastate or interstate) made by national banks. See

[4] The States recognize that section 85 has a number of other purposes, provisions, and effects that have different federalism implications. Those other aspects of section 85 are not implicated in this case, and are therefore not addressed in this brief. Rather, the States address in this brief only the provision of section 85 that is pertinent to the facts of this case.

Marquette Nat'l Bank v. *First of Omaha Serv. Corp.*, 439 U.S. 299, 318 n.31 (1978) (citing Cong. Globe, 38th Cong., 1st Sess. 1866 (1864)).

In the Senate, however, the bill was amended, and the current language of section 85 was added. See John Jay Knox, *A History of Banking in the United States* 255-56 (1903, 1969 reprint); Citibank Br. at 33-35. That decision was critically important. Mindful of basic principles of federalism, Congress rejected a rigid preemption approach to the regulation of national banks that would have trampled upon the traditional prerogatives of all of the states. Instead, Congress reserved to each state the power to make its own policy judgment on the interest limitations that would best serve the objectives of that state. Congress decided that, as a matter of federal law, the law of the bank's home state would determine the interest that a national bank may charge, even when the borrower resides in a different state.[5]

Thus, in the context of this case, section 85 does not operate at all like a conventional preemption statute. In a conventional preemption case, there is a conflict between

[5] Congress has also recognized the importance of state banking law in provisions subsequently added to the National Bank Act. *See, e.g.*, 12 U.S.C. § 36(c) (providing that a national bank may "within the approval of the Comptroller of the Currency, establish and operate new branches" within geographical limits "if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question"); 12 U.S.C. § 90 (upon deposit of funds by a state or state government agency, a national bank may "give security for the safekeeping and prompt payment of the funds so deposited to the same extent and of the same kind as is authorized by the law of the State in which [the national bank] is located in the case of other banking institutions in the State"); 12 U.S.C. § 92a (Comptroller of the Currency may grant a national bank the power "to act as trustee, executor, administrator, . . . or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located").

substantive federal and substantive state law. Under the Supremacy Clause, U.S. Const. art. VI, cl. 2, the federal law displaces the state law, and the state law is rendered entirely void and "without effect." *Maryland* v. *Louisiana*, 451 U.S. 725, 746 (1981); *Gibbons* v. *Ogden*, 22 U.S. (9 Wheat.) 1, 211 (1824).

In this case, however, the effect of section 85 is not to displace substantive *state* law with substantive *federal* law. Rather, as described above, section 85 serves to determine which state's law determines the permissible interest on an interstate loan transaction.

Moreover, Section 85 does not render the substantive law of California or any other state null and void. To the contrary, section 85 effectively preserves state law. Under section 85, the law of California determines the interest charges that a national bank located in that state may assess—whether its loans are made to residents of California or elsewhere.[6]

To be sure, section 85 does cause some displacement of state law: in an interstate loan, the law of the borrower's home state is displaced by the law of the bank's home state. But that displacement, alone, does not transform section 85 from a choice of law statute into a preemption statute. Rather, the displacement of the law of one state by the law of another is inherent in any conflict of laws determination. In any conflict of laws case, the law of one state "wins" and the law of another state "loses." That

[6] This Court recognized in *Marquette National Bank* that a consumer who borrows money from an out-of-state bank is deemed to have travelled to the bank to obtain the loan. 439 U.S. at 311. That is consistent with the structure of the National Bank Act, which prohibits a national bank from making loans at any location other than its home office or its branches. 12 U.S.C. §§ 36(j), 81. It is therefore unremarkable that Congress would determine in section 85 that the loan transaction should be governed by the law of the state in which the lender resides *and* in which the transaction occurs.

occurs without impairing state sovereignty or implicating conventional preemption concerns.[7]

Accordingly, conventional preemption concerns are simply not present in this case. This is not a case in which "the historic police powers of the States [are being] superseded by [a] Federal Act." *Cippollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (quoting *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Nor is this a case in which the historic prerogatives of the states are in need of "protection . . . against intrusive exercises of Congress' Commerce Clause powers." *Gregory* v. *Ashcroft*, 501 U.S. 452, 464 (1991). If it were, our States would not be before this Court urging affirmance of the decision of the California Supreme Court.

In adopting section 85, Congress chose to preserve the historic prerogatives of the states in determining the interest charges that banks located within their borders could assess. Congress did *not* enact a uniform set of national standards for the lending practices of national banks designed to preempt all contrary state law. Rather, Congress decided (as a matter of federal law) to incorporate the law of the bank's home state on this subject, thereby preserving to a great extent the traditional role of the states in bank regulation.

B. Petitioner's Construction Of The Scope Of The Choice Of Law Rule In Section 85 Would Lead To Uncertainty And Confusion In The Interstate Loan Market.

This Court has previously had an opportunity to review the meaning and scope of section 85. In the landmark decision in *Marquette National Bank*, *supra*, the respondent,

[7] For this reason, petitioner's argument that section 85 is an unconstitutional delegation of legislative power is incorrect. Any time a resident of California enters into a transaction with the resident of another state, there is the possibility—under standard conflict of laws rules—that the law of California may be displaced by the law of another state.

a national bank located in Nebraska, charged an 18 percent annual percentage rate ("APR") on all of its credit card accounts, including those held by residents of Minnesota. The 18 percent APR was permitted by Nebraska law, but violated Minnesota law. 439 U.S. at 302. In a unanimous opinion, the Court upheld the bank's loan charges. The Court cited the plain language of section 85 and held that the statute permits a national bank to charge all of its borrowers the APR permitted by the law of the bank's home state, even if that APR violates the law of the borrower's home state. *Id.* at 313.

In reaching that result, the Court recognized in *Marquette National Bank* that interstate credit card loans are made in the home state of the bank. The card holders are recognized as having come to the bank to obtain the loans. *Id.* at 311. Accordingly, the Court viewed interstate credit card loans as simply a modern-day example of the long-standing practice of interstate lending in this country. As the Court observed, "citizens of one State" have always been "free to visit a neighboring State to receive credit at foreign interest rates." *Id.* at 318.[8]

In *Marquette National Bank*, the loan charge at issue was the APR. Here, the question is whether section 85 also applies to late fees.

The California Supreme Court held that the term "interest" in section 85 includes late fees, and therefore that the rule in section 85 applies to those late fees. The state court's holding regarding the scope of section 85 is correct and benefits both borrowers and banks by providing certainty and predictability to interstate loan transactions.

[8] The holding of *Marquette National Bank* is sometimes described as the "exportation" of the law of the bank's home state to the borrower's home state. That is not, however, quite accurate. Because the loan is actually made at the bank, the application of the law of the bank's home state does not require the "exportation" of any law. To the contrary, exportation would have occurred in fact only if *Marquette National Bank* had held that the law of the borrower's state governed a transaction in the bank's home state.

At the time that the loan or credit card agreement is made, all of the parties know that the law of the bank's home state will determine the validity of the charges assessed by the bank.

If this Court were to reverse the state court's ruling, however, the result would *not* be, as petitioner and her *amici* suggest, that the law of the borrower's home state would automatically govern the permissibility of late charges. Rather, because the interests of at least two states are always involved in interstate loans, a difficult choice of law issue would arise that would need to be resolved through litigation in each of the 50 states, with each state applying its own conflict of laws rules. Until that issue were conclusively resolved in each of the 50 states, a virtual impossibility,[9] banks and card holders would not know whether the law of the bank's home state or the state of the card holder's residence—or potentially even the law of the state in which the purchase or cash advance was made—would apply.

Almost certainly, in the absence of the uniform choice of law rule provided by section 85, the states would reach

[9] The conflict of laws issue will never be truly "conclusively resolved," as states' approaches to conflicts of law questions may change over time. *See, e.g.*, Eugene F. Scoles & Peter Hay, *Conflict of Laws* 11-44 (2d ed. 1992) (describing evolution of general choice of law standards in the United States); *Duncan* v. *Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984) (rejecting traditional contract law rule of *lex loci contractus*, which applied the law of the state in which the contract was made, in favor of a rule applying the law of the state with the "most significant relationship" to the transaction); *Choate, Hall & Stewart* v. *SCA Servs., Inc.*, 392 N.E.2d 1045, 1048-49 (Mass. 1979) (also rejecting *lex loci contractus* rule); *Lilienthal* v. *Kaufman*, 395 P.2d 543, 545-47 (Or. 1964) (same); *Babcock* v. *Jackson*, 191 N.E.2d 279, 283-84 (N.Y. 1963) (rejecting traditional tort law rule of *lex loci delicti commissi*, which applied the law of the state in which the tort was committed, in favor of an approach comparing the interests of the competing states); *Reich* v. *Purcell*, 432 P.2d 727, 729-31 (Cal. 1967) (also rejecting *lex loci delicti commissi* rule).

different results through their choice of laws analysis. Some states, depending on their views of the interests of the competing states in governing the transaction and the lending charge at issue, would likely apply the law of the state of the borrower's residence to late charges.[10] Others would likely apply the law of the bank's home state.[11] As a result, determining which law applied to the various charges in a certain loan transaction might ultimately depend on the forum in which the litigation was brought.[12]

[10] *See, e.g.*, *Commercial Credit Equip. Corp.* v. *West*, 677 S.W.2d 669, 674 (Tex. Ct. App. 1984) (applying law of consumer's state in case involving purchase financing); *Dassault Falcon Jet Corp.* v. *Oberflex, Inc.*, 909 F. Supp. 345, 353 (M.D.N.C. 1995) (applying law of consumer's state in case involving sale of goods); *D.P. Technology Corp.* v. *Sherwood Tool, Inc.*, 751 F. Supp. 1038, 1040 (D. Conn. 1990) (applying law of commercial purchaser's state); *Collins Radio Co.* v. *Bell*, 623 P.2d 1039, 1045-48 (Okla. Ct. App. 1980) (same).

[11] *See, e.g.*, *Connecticut Nat'l Bank* v. *Kommit*, 577 N.E.2d 639, 640-41 (Mass. App. Ct. 1991) (enforcing choice of law clause in credit card agreement providing that law of bank's home state governs transaction); *Finance Am. Corp.* v. *Moyler*, 494 A.2d 926, 928-30 (D.C. 1985) (applying law of finance company's home state in consumer loan case); *OFS Equities, Inc.* v. *Conde*, 421 So. 2d 651, 653 (Fla. Dist. Ct. App. 1982) (applying law of lender's home state under "validation principle"); *Commercial Credit Plan, Inc.* v. *Parker*, 263 S.E.2d 220, 222 (Ga. Ct. App. 1979) (applying law of finance company's home state in consumer loan case); *Walker* v. *Associates Fin. Servs. Corp.*, 588 S.W.2d 416, 417-18 (Tex. Ct. App. 1979) (same); *cf. McBride* v. *Minstar, Inc.*, 662 A.2d 592, 598-99 (N.J. Super. Ct.) (holding that Massachusetts law governs both contract and tort claims of New Jersey resident who purchased ski equipment from retailer in Massachusetts), *aff'd sub nom. McBride* v. *Raichle Molitor, USA*, 662 A.2d 567 (N.J. Super. Ct. App. Div. 1995).

[12] If, for example, a court of Illinois determined, applying its conflict of laws rules, that Illinois law applies when a resident of Illinois borrows money from a bank in Ohio, courts in Ohio would of course be required to give full faith and credit to the final judgment of the Illinois court. U.S. Const. art. IV, § 1. In a case involving the same issues but different parties, however, the courts of Ohio would be free to reach a different result.

The inevitable result would be forum shopping with its devastatingly harmful effects on the administration of justice. See, *e.g.*, *Erie R.R.* v. *Tompkins*, 304 U.S. 64, 74-77 (1938) (condemning forum shopping). This structural (and perpetual) uncertainty would impose unnecessary costs on both banks and card holders and would further no one's legitimate interests.

Regardless of how the individual states were to resolve these difficult choice of law issues, the result of petitioner's construction of section 85 would be to balkanize the regulation of banks. The States would lose our historic prerogative to set the terms upon which the banks located within our borders may lend money. Instead, the interest charges on loans made by banks located within our borders would be regulated in part by our States and in part by the law of each state in which the credit card holder resides or the credit card purchase is made. This is an intolerable situation that could only be justified by the clearest evidence of congressional intent.

II. UNDER SETTLED RULES OF STATUTORY CONSTRUCTION, THE JUDGMENT OF THE CALIFORNIA SUPREME COURT SHOULD BE AFFIRMED.

This case presents a straightforward question of statutory construction. As explained above, section 85 operates here in effect as a choice of law rule, not as a statute preempting substantive state law, and does not raise the states' rights or federalism concerns normally associated with conventional preemption statutes. Accordingly, this case should not be governed by the principles of statutory interpretation that apply in the context of preemption. See, *e.g.*, Pet. Br. at 12-18. Rather, the standard and settled rules of statutory construction should apply. The judgment of the California Supreme Court should be affirmed because its interpretation of section 85 is consistent with (1) the language of the statute as interpreted in the formally adopted rule of the OCC, the federal agency charged with administering the National Bank Act, (2) the policies and purposes of Congress in enacting the National Bank Act, and (3) economic reality and this Court's prior rulings.

A. Deference To The OCC's Interpretation Of Section 85 Is Appropriate And Essential To Ensuring The Safety And Soundness Of Banks Within Our Borders.

Numerous nineteenth century statutes and cases define or use the word "interest" in a broad sense, to include all payments for the use of funds, including damages for the detention of funds past the maturity date of the loan. See Citibank Br. at 16-21, 25-30. Thus, the plain meaning of the statute in 1864 and today is a sufficient basis in itself to affirm the decision below.

In arguing for a different interpretation of section 85, petitioner is unable to demonstrate that the language of the statute compels the conclusion that late charges must be excluded from its sweep. In her opening brief, petitioner concedes as much, acknowledging that "interest" in section 85 is not limited to the APR, but may also include other fees in certain circumstances. See, *e.g.*, Pet. Br. at 30-31 & n.14. At bottom, all that petitioner attempts to show is that the term "interest" in section 85, read in isolation, is potentially ambiguous.

The proper resolution of this case, however, is the same whether the statutory language is deemed to be plain or ambiguous. That is because when a statute is ambiguous, the first rule of federal statutory interpretation directs courts to determine whether the federal agency charged with administering the statute has issued an authoritative interpretation of the relevant language. As the Court has explained:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with

> two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter . . . . If, however, . . . the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984); see also, *e.g.*, *Nationsbank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995) ("It is well settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute.").

The OCC is charged with administering the National Bank Act. 12 U.S.C. §§ 1, 26-27, 481; *Nationsbank*, 115 S. Ct. at 813. The OCC's interpretation of any ambiguity in the National Bank Act is therefore entitled to deference by the courts, and any reasonable interpretation of the Act by the OCC is conclusive of the issue. *Id.* This deference is based, in part, on the fact that Congress has delegated this policy-laden task to an administrative agency and, in part, on the recognition that administrative agencies develop a high level of expertise in their complex regulatory fields. See, *e.g.*, *Chevron*, 467 U.S. at 864-66; Cass R. Sunstein, *Law and Administration After Chevron*, 90 Colum. L. Rev. 2071, 2086-90 (1990). It is neither institutionally appropriate nor wise policy for federal courts to interfere with the judgments made by the OCC.

The OCC recently promulgated a final rule expressly interpreting the word "interest" in section 85. The OCC's rule states:

> The term "interest" as used in 12 U.S.C. § 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. *It includes, among other things, . . . late fees . . . .*

61 Fed. Reg. 4849, 4869 (Feb. 9, 1996) (emphasis added) (to be codified at 12 C.F.R. § 7.4001(a)). This rule is consistent with opinion letters issued by the OCC in 1980, 1988 and 1992,[13] with statements issued by other federal banking agencies,[14] and with the overwhelming majority of lower court cases holding that the term "interest" in section 85 and in section 521 of the DIDA includes late fees and other charges incident to the extension of credit.[15]

As respondent ably demonstrates, the conditions for deference to the OCC are met in this case. Citibank Br.

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[13] Letter of William P. Bowden, Jr., OCC Chief Counsel, 1992 WL 136390 (OCC) (Feb. 4, 1992); OCC Interpretive Ltr. No. 452, [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 (Aug. 11, 1988); Letter from Richard V. Fitzgerald, Director, OCC Legal Advisory Services Division (Nov. 24, 1980).

[14] Letter of Harry Quillian, Acting General Counsel, FHLBB (June 27, 1986), attached to Letter of Karen Solomon, Deputy Chief Counsel, Office of Thrift Supervision (Sept. 29, 1994), in Current Developments, Fed. Banking L. Rep. (CCH) ¶ 82,852 (Dec. 16, 1994); Advisory Op. No. FDIC-92-47, [1992-93 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (July 8, 1992).

[15] *E.g.*, *Cades* v. *H & R Block, Inc.*, 43 F.3d 869 (4th Cir. 1994) (flat $29 charge for tax refund anticipation loans), *cert. denied*, 115 S. Ct. 2247 (1995); *Greenwood Trust Co.* v. *Massachusetts*, 971 F.2d 818, 829 (1st Cir. 1992) (noting that courts construing section 85 "have had little trouble in construing the term 'interest' to encompass a variety of lender-imposed fees and financial requirements which are independent of a numerical percentage rate"), *cert. denied*, 506 U.S. 1052 (1993); *American Timber & Trading Co.* v. *First Nat'l Bank*, 690 F.2d 781 (9th Cir. 1982) (charges incurred under compensating balance requirements); *Fisher* v. *First Nat'l Bank*, 548 F.2d 255 (8th Cir. 1977) (credit card cash fees); *Northway Lanes* v. *Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855 (6th Cir. 1972) (closing costs).

at 35-41. Accordingly, under the principles of *Chevron* and its progeny, the Court should defer to the authoritative interpretation of the National Bank Act promulgated by the OCC.

In addition, there are particularly compelling reasons here for according deference to the OCC's interpretation of the National Bank Act. First, banking officials in our States are involved on a daily basis in the supervision, examination, and regulation of state-chartered banks. State banking officials rely as a matter of course upon the official pronouncements of the OCC, the FDIC, and other federal bank regulatory agencies in interpreting the myriad federal statutes that apply to state banks. That reliance promotes certainty and efficiency in bank regulation, and accords proper respect to the role assigned by Congress to the expertise developed by the federal agencies in this field.

Specifically in this case, bank regulators in our States relied upon the OCC's interpretation of the National Bank Act to ensure that banks subject to our regulatory jurisdiction were in full compliance with applicable laws. If the OCC or FDIC had taken a different position regarding the meaning of section 85, our bank regulators would have reexamined the issue to ensure that the state-chartered banks located in our States were complying with the law.

Reversing the OCC's interpretation of the National Bank Act, however, would upset the settled and reasonable expectations regarding the meaning of section 85 in the industry and would undermine the certainty and efficiency interests set forth above. If the OCC's interpretation of section 85 were discarded, then the ability of state regulators to assume the validity of stated interpretations of federal banking statutes issued by federal banking agencies would be severely diminished, if not eliminated altogether.

Second, the banks within our borders also rely upon the statements of federal banking agencies in ensuring that

their practices are in accordance with the law. In reliance upon the OCC's interpretation of the National Bank Act, banks in our States have loaned literally hundreds of billions of dollars to consumers across the country. Given the amount of money at stake in this case, accepting petitioner's interpretation of the National Bank Act would have a seriously harmful effect on banks in our States. Individual banks would suddenly and unexpectedly be exposed to significant damage claims. Collectively these claims could readily exceed billions of dollars.

Moreover, the harm would not be limited to the banking industry. Rather, the potentially massive liability of banks could have an adverse effect on the entire economy of most, if not all, of the States. The ultimate impact could be loss of jobs, loss of tax revenues, and an overall tightening of credit. As a result, businesses, consumers, and all residents in this nation would suffer.

In interpreting section 85, great weight should be accorded to justifiable reliance interests. The substantial history of reliance, and the potential widespread harm that would result from undermining the reliance interests, counsel strongly against the adoption of a new, unsupported interpretation of the National Bank Act. See, *e.g.*, *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 457-58 (1978) ("In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.'"); *Train* v. *Natural Resources Defense Council, Inc.*, 421 U.S. 60, 87 (1975) (deferring to EPA's interpretation of Clean Air Act in part because "there has undoubtedly been reliance upon [the EPA's] interpretation by the States and other parties affected by the Act"); 2B Norman J. Singer, *Sutherland on Statutes and Statutory Construction* § 49.07, at 62 (5th ed. 1992) (one reason for sustaining a long-standing statutory interpretation "is the fact that the public has relied on the interpretation").

B. The State Court's Construction Of Section 85 Furthers Congress' Purposes In Enacting The National Bank Act.

Interstate lending was a well-established practice in this country long before the National Bank Act was adopted. *Marquette Nat'l Bank,* 439 U.S. at 317. Through the National Bank Act, "Congress intended to facilitate . . . a 'national banking system,'" *id.* at 314-15, to create "a banking system of great regional interdependence," *id.* at 316, and to promote interstate lending generally, *id.* at 314-18. The California Supreme Court's construction of the National Bank Act furthers the Act's manifest purposes.

First, the state court's ruling provides certainty and predictability to interstate lending. Banks may lend money to borrowers in other states knowing with certainty that only the law of the bank's home state, not the law of any other state, will govern the transaction.

Accepting petitioner's interpretation of the National Bank Act, however, would, as already demonstrated (*supra,* pp. 12-14), have precisely the opposite effect, causing substantial uncertainty. In the face of that uncertainty, banks would be likely to adopt conservative lending practices that would increase the cost of credit and would restrict access to credit. Moreover, banks that continued to make interstate loans and to issue credit cards to out-of-state customers would risk incurring enormous liability in class actions, such as this one, if they were to predict wrongly which state's law applied to certain loan charges. See William C. Dunkelberg, *Litigation Concerning Late Charges is Major Threat to Credit Card Business,* Banking Pol'y Rep. (Prentice Hall), Apr. 6, 1992, at 1, 15-16. No prudent lender will take that risk.

Second, the California Supreme Court's construction of the National Bank Act promotes efficiency and reduces costs in interstate lending. Under the state court's ruling, banks need to monitor statutory, regulatory, and judicial

developments in banking law in only one state—the bank's home state. The cost of administering interstate loans and credit card accounts remains low, because all loans and accounts are governed by one set of laws.

Petitioner's interpretation of the statute, however, would impose substantial administrative burdens on banks. To engage in interstate lending, banks would be required to design and maintain a system that would incorporate all statutory, regulatory, and judicial law relating to loan charges in all 50 states—and to monitor the statutory, regulatory, and judicial changes in the law in each state—in order to ensure that each borrower was being assessed the correct charges for each loan. See William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare,* 1995 Utah L. Rev. 1009, 1024 (1995). Requiring banks to comply with myriad, conflicting laws in each jurisdiction where their credit card holders and other borrowers reside would undermine certainty and predictability in interstate lending, and could, as this Court has stated, "throw into confusion the complex system of modern interstate banking." *Marquette Nat'l Bank,* 439 U.S. at 312. At the very least, accepting petitioner's argument would cause an increase in the cost of interstate lending and a reduction in the amount of interstate lending—precisely the opposite of what Congress intended when it adopted the Act.

C. The California Supreme Court's Construction Of Section 85 Is Consistent With The Economics Of Credit Pricing And Thus Constitutes A Common Sense Approach To Applying The Statute.

Banks typically charge a number of closely related fees for credit cards. The most prominent of these fees is the APR. Other fees include the late charges at issue in this case, as well as annual fees, over-the-limit fees, and fees for returned checks used to pay off a credit card balance. All of these fees, in the aggregate, constitute the "price" of the credit card to the consumer.

The application of section 85 to one of these fees—the APR—was settled by this Court in *Marquette National Bank*. As noted above, the Court held that section 85 allows a national bank to charge the APR permitted by the law of its home state, even if that APR violates the law of the borrower's home state. 439 U.S. at 313.

The instant case involves late fees, and not the APR. But late fees and APR are simply two components of the price of credit to the card holder. There is no basis in logic or economics to treat the loan differently, or to apply a different choice of law rule, simply because a late fee, rather than the APR, is at issue. Indeed, one court has aptly stated that the definition of "interest" in section 85 should be governed by "[w]hat affects the borrower's pocketbook . . . , not semantics." *First Nat'l Bank* v. *Nowlin*, 509 F.2d 872, 878 (8th Cir. 1975).

Moreover, as noted above, Congress' intent in enacting the National Bank Act was to promote interstate banking while at the same time preserving the states' historic prerogatives with regard to bank regulation. The intent that petitioner imputes to Congress, however, is wholly implausible. According to petitioner, Congress actually intended in 1864 to preserve the states' traditional role in controlling certain loan charges, but at the same time intended to *deprive* the states of that role with regard to other, closely related loan charges.[16] There is no evidence and no reason to assume that Congress intended to create such an illogical and unworkable regulatory scheme.

[16] As respondent shows, in the context of intrastate loans by a national bank, the term "interest" must include late charges. Because there is no reason to believe that the term should have a different meaning for interstate loans, "interest" must also include late charges on interstate loans. Citibank Br. at 35.

III. SECTION 85 PROMOTES BOTH THE INTERESTS OF CONSUMERS AND THE ABILITY OF EACH STATE TO PROTECT ITS RESIDENTS AS IT SEES FIT.

Consumers in our States and across the country benefit from broad access to credit, low credit card costs, and the ability to choose from the broadest possible range of competing credit cards, offering the broadest possible range of packages of rates and charges, in the marketplace. The Truth In Lending Act, 15 U.S.C. § 1601 *et seq.*, state disclosure laws, and state anti-fraud protections ensure that credit card issuers must disclose all material terms so that consumers are able to make informed choices among competing credit card products. Any state that is dissatisfied with existing protections can enhance its own disclosure and anti-fraud laws. It is no solution to make a substantive shambles of the interstate banking system, which has served the nation well for decades.

With the broadest possible range of choices in the market and the extensive disclosures required by the Truth In Lending Act, consumers are able to obtain credit cards that fit their individual usage and payment preferences. For example, consumers who pay the outstanding balance in full each month are likely to choose a credit card that does not charge an annual fee and that offers perquisites such as airline frequent flier miles or no-cost insurance on rental cars, even if the card also charges a relatively high APR and imposes late fees. In contrast, consumers who plan to use a card for easy access to unsecured credit are likely to choose a card that offers a low APR and no late charges, even if the card also charges an annual fee and offers no "perks." See David S. Evans & Richard L. Schmalensee, *The Economics of the Payment Card Industry* 51, 58-60 (1993); Christopher C. DeMuth, *The Case Against Credit Card Interest Regulation*, 3 Yale J. on Reg. 201, 236, 238-39 (1986).

The California Supreme Court's construction of section 85 promotes broad competition in the interstate credit

card market. Banks will be able to issue cards to consumers across the country with the certainty that the law of the bank's home state will govern not only the APR but also late charges. As a result, consumers in our States will be able to choose from a broad array of competing credit cards, some of which will be offered by banks in states which restrict some loan charges and others of which will be offered by banks in states with no such restrictions.

For example, Minnesota law severely limits the ability of banks to charge late fees, Minn. Stat. § 48.185(4), but banks in Ohio are permitted to offer cards that do charge late fees, Ohio Rev. Code § 1107.262(A). When competing for customers against Minnesota card issuers—whether in Ohio, Minnesota, or somewhere else—the Ohio banks must offer other, more favorable terms (for example, a low APR or no annual fee) in order to compete with cards from the Minnesota banks that do not charge late fees. Thus, consumers in every state will be able to choose between (1) cards from banks in Minnesota, which do not assess late charges and (2) cards from banks in Ohio, which do assess late charges but in return offer a low APR or no annual fee. Under petitioner's construction of section 85, in contrast, consumers would have fewer choices and would therefore be worse off. See Baxter, at 1020-21; DeMuth, at 231, 239.[17]

By permitting each state to set its own policy concerning credit card fees and charges that governs its home

[17] Contrary to the suggestion of one of petitioner's *amici*, nothing in the California Supreme Court's interpretation of section 85 would give out-of-state national banks a competitive advantage over local banks, even if by law they are permitted to charge more than local banks. In the example above, if the Ohio bank charges late fees without offering a low APR or no annual fee to its Minnesota customers, it will be at a competitive *disadvantage* compared to Minnesota banks. Consumers in Minnesota will choose to obtain credit cards from Minnesota banks, which will be offering a lower overall price for credit cards.

banks' practices, the California Supreme Court's interpretation of section 85 benefits consumers in our States and throughout the country. It permits banks to offer consumers a wide variety of credit card products in an industry that is characterized by intense competition. Evans & Schmalensee, at 68-71; Baxter, at 1013-19; DeMuth, at 222-26. Armed with a variety of choices offered by banks and other credit card issuers, and with full disclosure of credit terms, including late fees, mandated by federal law, consumers will continue to have the credit card product that best suits their particular needs.

In an attempt to argue that the California Supreme Court's interpretation of section 85 will harm consumers, petitioner and her *amici* make the broad argument that late charges are inherently unjust or unfair. But this argument cannot dictate the proper construction of section 85.[18] Whether banks should be allowed to impose late charges is a question of policy, better suited for Congress and the state legislatures than for this Court. Some states choose to prohibit late fees. Other states choose to permit them. Either choice is rational and within the traditional prerogative of the states to regulate the lending practices of banks located within their borders.[19]

[18] Moreover, petitioner and her *amici* are simply wrong that late fees are flatly unjust. States that permit late fees have recognized that there is no social utility in late payments, that late payments impose substantial costs on lenders, and that it is therefore "just" to permit card issuers to require the defaulting cardholders to pay for the consequences of their actions. If credit card issuers were not permitted to charge late fees, then those costs would have to be borne by all card holders—in the form of higher APR's, higher annual fees, or fewer perks. *See* Dunkelberg, at 16. Prohibiting late fees thus has the unfortunate effect of requiring the vast majority of cardholders who make their monthly payments on time each month to subsidize the few who pay late. *Id.*; Baxter, at 1025. Permitting banks to charge late fees, in contrast, compensates the banks for the costs of late payments (including increased credit risk) and deters borrowers from making late payments.

[19] Since 1990, the Legislatures of at least 16 states (including several states that have joined the *amicus* brief in support of peti-

Petitioner's *amici* also claim that, under the California Supreme Court's construction of section 85, "consumers subjected to unfair or illegal credit and collection practices by an out-of-state national bank will have no recourse to their state consumer protection authorities." *Amici* Brief of Mass., *et al.*, at 9. But that is not what section 85, or this case, is about. Consumer protection laws (such as the Truth In Lending Act) protect consumers from fraud and deception. Nothing in section 85 interferes in any way with the ability of the Attorneys General and the various consumer protection agencies of our States from taking strong and immediate action against any card issuer that engages in fraudulent or deceptive credit or collection practices.

Moreover, under the California Supreme Court's construction of section 85, residents of a state are guaranteed

titioner) have recognized that late charges are *not* inimical to consumer interests, and have passed new laws either authorizing credit card late charges or increasing the amount of the late fees that may be assessed. *See* Ariz. Rev. Stat. § 44-1205.C.4 (allowing late charge in any amount agreed to with borrower); Cal. Fin. Code § 4001(a)(1)(C) (allowing late charge up to $15); Colo. Rev. Stat. § 5-3-203 (allowing late charge up to $15); Ind. Code § 24-4.5-3-203.5(4), as amended by rule, 3 Consumer Cred. Guide (CCH) Ind. ¶ 6531 (allowing late charge up to $14.50); Iowa Code § 537.2502.8 (allowing late charge of $10); Kan. Stat. Ann. § 16a-2-502(2) (allowing late charge up to $10); Me. Rev. Stat. tit. 9-A, § 2-501(1)(G) (allowing late charge of lesser of $10 or 5 percent of unpaid balance); Mass. Gen. L. ch. 140, § 114B (allowing late charge of lesser of $10 or 10 percent of unpaid balance); N.J. Stat. Ann. § 17:16C-42(a) (allowing late charge up to $10); N.Y. Banking Law § 108(5)(e); N.Y. Pers. Prop. Law § 413(5)(b) (allowing late charge in any amount agreed to with borrower); Okla. Stat. tit. 14A, § 3-203(5), as modified by rule, 4 Consumer Cred. Guide (CCH) Okla. ¶ 6901 (allowing late charge up to $15); Pa. Stat. Ann. tit. 7, § 322(d)(v) (allowing late charge of greater of $20 or 10 percent of unpaid balance); S.C. Code §§ 37-3-203, 37-1-109 (allowing late charge of lesser of $12 or 5 percent of unpaid balance); Utah Code § 70C-2-102(1) (allowing late charge of greater of $20 or 5 percent of unpaid balance); Va. Code Ann. § 6.1-330.78.A.1 (allowing late charge in any amount agreed to with borrower); Wis. Stat. § 422.202(2m)(a) (allowing late charge up to $10).

the full benefits of the state's rate regulation laws as long as they use credit cards issued by banks in the borrower's home state. See Baxter, at 1025. When a card holder uses a credit card issued by a bank in another state, however, the card holder is deemed to have travelled to the home office of the bank to obtain the loan. *Marquette Nat'l Bank*, 439 U.S. at 311. A state has little interest in regulating the terms of a transaction when its resident has made the choice to travel to *another* state to obtain consumer goods, such as a television or ski equipment, leaving behind the consumer protection laws of the resident's home state. See, *e.g.*, *McBride* v. *Minstar, Inc.*, 662 A.2d 592, 598-99 (N.J. Super. Ct.) (holding under New Jersey's choice of law rules that the claims of a New Jersey resident who purchased allegedly defective ski equipment from a retailer in Massachusetts are governed by Massachusetts law) *aff'd sub nom. McBride* v. *Raichle Molitor, USA*, 662 A.2d 567 (N.J. Super. Ct. App. Div. 1995). Likewise, a state has little interest in regulating the terms of a transaction when its resident has made the choice to travel to another state to obtain a loan from a bank there, leaving behind the interest rate ceilings of the resident's home state. See, *e.g.*, *Commercial Credit Plan, Inc.*, v. *Parker*, 263 S.E.2d 220, 222 (Ga. Ct. App. 1979) (applying South Carolina law to loan from South Carolina finance company to Georgia borrower, under terms that were prohibited by Georgia law, because borrower had travelled to South Carolina to obtain the loan and "the public policy of [Georgia] . . . does not extend to the enforcement of valid contracts made in other states"); *Walker* v. *Associates Fin. Servs. Corp.*, 588 S.W.2d 416, 417-18 (Tex. Ct. App. 1979) (applying Indiana law to loan obtained by Texas resident by mail from Indiana finance company).[20]

[20] In addition, as this Court recognized in *Marquette National Bank* some "impairment" of the ability of the states to enforce laws limiting loan charges "has always been implicit in the structure of the National Bank Act, since citizens of one State were free to visit

Another *amicus* contends that consumers, when choosing from among various credit card options, do not consider components of the price other than APR. This contention defies both common sense and elementary economic theory. Moreover, it is contrary to the actual experience of the credit card industry. In the years after the Court's decision in *Marquette National Bank*, credit cards issued by banks in heavily regulated states have been in direct competition with credit cards issued by banks in less regulated or deregulated states. DeMuth, at 231. Although banks in regulated states generally offer a lower APR than banks in deregulated states, the number of credit cards and amount of credit extended by banks in deregulated states has grown at a much faster rate than that of banks in regulated states. *Id.* at 232-36. The explanation is not that consumers prefer to pay a higher APR; rather, the experience of the credit card industry demonstrates that consumers are willing to pay a higher APR in order to obtain credit cards that are of greater value to the consumers because the cards offer better service, additional features or "perks," and broader access to credit. *Id.* at 236-37.

At bottom, then, petitioner and her *amici* are not seeking to give effect to the intent of Congress, or to protect the historic prerogatives of the states, or even to promote consumer welfare. Rather, petitioner and her *amici* seek the assistance of this Court in supporting a category of products—credit cards offered by banks in highly regulated states—that is losing the battle of competition in the credit card market. That case should be presented to Congress, not this Court.

The ultimate effect of accepting petitioner's interpretation of section 85 is clear. The cost of credit for consumers in our States and elsewhere will rise, consumers will have fewer choices in credit card packages, and there will be less credit available overall, particularly for those perceived as the greatest credit risks, including the lower and middle income individuals of our States. See Evans & Schmalensee, at 112-13; Baxter, at 1021-23; DeMuth, at 239-41 & n.102. To be sure, Congress would have the power to adopt such a "silly" law, but it did not do so in section 85. *Cf. TVA* v. *Hill*, 437 U.S. 153, 194-95 (1978).

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a neighboring State to receive credit." 439 U.S. at 318. As was true in *Marquette National Bank*, the plea of petitioner here to "alter" section 85 in order to enable the states to apply their lending regulations to interstate loans is "an issue of legislative policy" that "is better addressed to the wisdom of Congress than to the judgment of this Court." *Id.* at 319.

At the end of the day, section 85 (and its analog, section 521 of the DIDA), as interpreted by the California Supreme Court, ensures that states retain the ability to set the terms upon which banks located within our borders may lend money. In contrast, petitioner's interpretation of section 85 interferes with this historic right and would permit other states to govern the lending activities of banks within our borders. Our States urge this Court to reject this intrusion into our legitimate prerogatives.

CONCLUSION

For the foregoing reasons, the Court should affirm the judgment of the California Supreme Court.

Respectfully submitted,

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INTEREST OF AMICI

This amici curiae brief is filed by American Bankers Association ("ABA"), American Financial Services Association ("AFSA"), Consumer Bankers Association ("CBA"), MasterCard International Incorporated ("MasterCard"), National Retail Federation ("NRF"), and VISA U.S.A. Inc. ("VISA") (collectively, "Amici") in support of respondent Citibank (South Dakota), N.A.[1]

The ABA is the largest national trade association of the commercial banking industry in the United States, representing approximately 90 percent of the domestic assets of all American commercial banks. The AFSA represents over 300 companies, including many depository institutions, that operate more than 10,000 offices extending consumer credit in the United States. The CBA represents institutions that collectively hold nearly 80 percent of all consumer deposits and about 70 percent of all consumer credit held by federally-insured depository institutions. VISA and MasterCard are associations that, as of year-end 1994, had approximately 17,000 and 13,600 depository institution members, respectively. The NRF is a trade association comprised of more than 55,000 members who are engaged in retail businesses throughout the United States.

Depository institutions are vitally interested in the question of whether late fees on credit card accounts are "interest" within the meaning of 12 U.S.C. § 85 ("Section 85"). That section governs the interest that may be charged on any loan made by a national bank, but other banks, savings associations, and credit unions also are affected by this Court's interpretation of Section 85 because Sections 521-523 of the Depository Institutions Deregulation

[1] Petitioner and Respondent each have provided consent to Amici's filing, pursuant to Supreme Court Rule 37.3.

and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980) ("DIDA"), grant these institutions the same federal interest authority that national banks have under Section 85. Members of the NRF are affected significantly by Section 85 because credit cards issued by depository institutions provide a crucial payment mechanism and source of credit necessary for the retail sales industry.[2]

Federally-insured depository institutions have relied on the long-standing interpretation of Section 85 by the Office of the Comptroller of the Currency ("OCC") in lending tens, if not hundreds, of billions of dollars on interstate credit card programs. If the OCC's position is set aside in this case, these credit card issuers could be subject to late fee limits under the various laws of the borrowers' states. Over 45 lawsuits and state administrative enforcement actions on this issue have been filed in recent years in Alabama, California, Colorado, Iowa, Maine, Massachusetts, Minnesota, New Jersey, Pennsylvania, South Carolina, and Wisconsin. If the theories asserted by the plaintiffs in these cases were successful, the potential liability under state law could include loss of periodic percentage charges on the accounts, as well as multiples of the late fees being challenged, for the applicable statute of limitations period under state law. Any such result would seriously undermine the justifiable reliance that depository institutions have placed on the federal banking agencies' interpretations of the laws they administer.

SUMMARY OF ARGUMENT

The OCC, the federal regulatory agency charged with interpreting and enforcing the National Bank Act, has issued a

[2] This brief relates to credit cards issued by depository institutions, and does not address credit cards issued by retailers. The members of the NRF thus, in this brief, express the views of merchants that accept credit cards rather than issuers of credit cards.

regulation that late fees are covered by Section 85. 61 Fed. Reg. 4849, 4869 (1996) (to be codified at 12 C.F.R. § 7.4001(a)). This interpretation reflects the agency's long-held position and is supported by extensive authority, including this Court's decisions which hold that the term "interest" includes "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873).[3] The OCC's regulation thus should be controlling in this case. *See NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995).

Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978), established conclusively that a national bank is authorized by Section 85 to charge interest at the rate allowed by the laws of the state in which the bank is located on loans made to borrowers who reside in other states (the "home state interest rule"). In doing so, this Court recognized that Section 85 was intended to foster national competition that allows borrowers to choose from a wide variety of credit products offered by lenders located nationwide under the laws of their respective states. Congress reaffirmed the primary importance of such national competition by providing other federally-insured depository institutions with the benefits of the home state interest rule when it enacted Sections 521-523 of DIDA.

Marquette recognized that borrowers shop nationally for credit by interstate mail and telephone. Borrowers now also can obtain interstate credit through computer networks. Section 85 provides that the interest laws of the bank's state apply to these interstate loans, just as if the borrower were to obtain a loan by physically visiting a branch of the bank in

[3] The compelling reasoning for this interpretation is restated at length in OCC Interpretive Letter No. 676, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618 (Feb. 17, 1995).

another state. The laws of the borrower's state are not properly applied to such interstate transactions occurring in the bank's state.

The benefits of national competition in the credit industry are well-illustrated by the credit card industry, which is the subject of this brief. This Court's decision in *Marquette* and the home state interest rule have been instrumental in developing true national competition.[4] Credit card issuers located across the country vie for the business of borrowers who reside in every state. The result has been what the Board of Governors of the Federal Reserve System ("Board") has described as an intensely competitive credit card industry. Indeed, the industry is structurally competitive by traditional measures, and its growth, entry of new competitors, aggressive competition for new customers, and competitive pricing and profitability all belie any assertion that the industry does not perform competitively.

Petitioner's interpretation of Section 85 would eviscerate *Marquette* by allowing state-by-state regulation of a significant component of the loan compensation on interstate credit cards.[5] Periodic percentage charges, late fees and other interest charges on credit card accounts are interdependent as a matter of both law and economics. Requiring state-by-state compliance with late fee limits effectively would require state-by-state compliance with all elements of loan compensation

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[4] *See* William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 Utah L. Rev. 1009, 1021 (1995) ("Baxter") (citations to page proofs obtained from publisher); David S. Evans and Richard L. Schmalensee, *The Economics of the Payment Card Industry* 29 (1993) ("Evans & Schmalensee").

[5] For ease of reference, this brief refers to interest (compensation for the use, forbearance or detention of money) as "loan compensation."

and unduly interfere with national competition in the credit card industry.

Petitioner's argument also fails to recognize that this Court has held that Section 85 incorporates state law on the permissible methods (or rates) by which interest is calculated, and not merely any limit on the ultimate amount of interest that may be charged. *See, e.g., Citizens' Nat'l Bank v. Donnell*, 195 U.S. 369 (1904). The laws of the bank's state thus determine whether loan compensation may be calculated by a flat or percentage rate, and whether applicable rates are applied during the term of the loan to calculate periodic charges or, when a borrower misses a payment, to calculate a late fee. The laws of the bank's state therefore determine the permissible allocation of loan compensation between the APR and late fees.[6]

If Section 85 does not apply to late fees, the federal standard can prove unworkable in many situations because Section 85 would adopt only a portion of the state standard that relates to loan compensation. For interstate loans, Section 85 thus could create an unworkable hodgepodge of laws of the bank's state and the borrower's state that was not intended by either state, and could cause anamolous results that adversely affect national competition.

Petitioner's theories, if accepted, would harm consumers. The home state interest rule allows consumers to choose from alternative price structures (methods of calculating loan compensation) under the laws of any state in the nation. Consumers can choose the price structure that best meets their individual needs. Limits on permissible price structures through limits on late fees preclude competitive pricing in

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[6] For purposes of this brief, the term "APR" refers to the annual percentage rate that corresponds to the monthly or other periodic percentage rate charged on the account.

which late payers who present higher credit risks and cause increased operational expenses can be charged appropriately without subsidization from other borrowers.

Imposing state law limits on the price at which credit is made available in the competitive credit card industry unnecessarily restricts the availability of credit, particularly to those borrowers that have the most difficulty obtaining credit. Petitioner's interpretation of Section 85 also needlessly applies multiple state laws on the price of credit cards, which decreases the efficiency of providing credit card services and leads to higher prices and/or lower-quality services for consumers.

In sum, Petitioner's arguments should be rejected because they are inconsistent with both the congressional policies underlying Section 85 and this Court's decisions, and do not benefit consumers.

ARGUMENT

I. SECTION 85 HAS PROMOTED NATIONAL COMPETITION IN THE CREDIT CARD INDUSTRY

Marquette firmly establishes that Congress adopted the home state interest rule in Section 85 with full knowledge of the extensive interstate lending activities in which national banks would be engaged. The Court explained:

> [The] debates [surrounding Section 85] occurred in the context of a developed interstate loan market. As early as 1839 this Court had occasion to note: "Money is frequently borrowed in one state, by a corporation created in another. The numerous banks established by different states are in the constant habit of

> contracting and dealing with one another. . . . These usages of commerce and trade have been so general and public, and have been practiced for so long a period of time, and so generally acquiesced in by the states, that the Court cannot overlook them . . . ." Examples of this interstate loan market have been noted by historians of American banking. Evidence of this market is to be found in the numerous judicial decisions in cases arising out of interstate loan transactions.

439 U.S. at 317 (alterations in original; citations omitted). *Marquette* thus recognized that Section 85 authorizes national banks located in different states with different interest laws to compete with each other nationally on the basis of the interest charges allowed by their home states.

When Section 85 was first enacted at the time of the Civil War, there were good reasons to adopt federal banking laws that would facilitate interstate commerce among the then-divided states. Through the home state interest rule, Congress prevented balkanized state credit industries by ensuring that national banks could compete freely on a national basis. From the borrowers' perspective, the rule ensured that they would have the opportunity to obtain credit at national prices in the truest sense: any price allowed by the laws of any state in the nation. Section 85 thus significantly increased both the available sources and the terms of credit.

The national competition recognized by *Marquette* occurs when borrowers who reside in one state obtain a loan product in another state at the price allowed by the other state. In upholding the home state interest rule against the claim that it improperly impaired the states' ability to "enact effective usury laws," *Marquette* noted that such impairment "has always been implicit in the structure of the National Bank Act,

since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates" and that such impairment "may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards." *Id.* at 318-19. *Marquette* thus established that a borrower obtains an interstate loan in the bank's state as if he or she visited that state in person. *Cf.* 12 U.S.C. § 81 (a national bank must conduct its loan business at its licensed branches or main office).

Congress reaffirmed its commitment to national competition in the credit industries, including the credit card industry, just two years after *Marquette* when Sections 521-523 of DIDA were enacted. This legislation provided other federally-insured depository institutions with the same interest authority that national banks have under Section 85.[7] Other federally-insured lenders thus were authorized to offer their home states' interest rates nationally without regard to state limits under the laws of the borrowers' states. The result was increased national competition from numerous other federally-insured depository institutions.

The enactment of Sections 521-523 of DIDA is significant in at least two respects. First, these federal statutes were enacted with the express congressional goal of establishing competitive equality between the other federally-insured depository institutions and national banks regarding the interest that could be charged. *See Greenwood Trust Co. v. Massachusetts*, 971 F.2d at 826. The ability to charge home state interest on interstate loans was a significant competitive advantage that national banks had over other depository institutions before enactment of Sections 521-523 of DIDA.

[7] *See generally Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992) (Section 521), *cert. denied*, 506 U.S. 1502 (1993); *Gavey Properties/762 v. First Fin. Sav. & Loan Ass'n*, 845 F.2d 519 (5th Cir. 1988) (Section 522).

Absent that authority, borrowers would not have the choice of the pricing offered by these depository institutions under the laws of other states.

Second, Sections 521-523 of DIDA were enacted when interest rates were at historic highs and low interest rate limits under some state laws significantly reduced the availability of credit to the point of adversely affecting the economy. *Id.* Sections 521-523 helped alleviate this credit crunch by authorizing additional depository institutions located in higher interest rate states to charge those rates to borrowers in low-rate states.

The importance of national competition in the credit card industry increases almost daily with fast-paced technological advances. Just as developments in interstate mail and telephone systems have facilitated the ability of cardholders to obtain credit in the bank's state, borrowers currently can obtain credit from a multitude of lenders nationwide through computer networks such as the Internet.[8] As technological advances quickly expand consumers' access to credit in other states, the home state interest rule embodied in federal law preserves for consumers the ability to shop for credit in different states and to obtain credit products available under those states' laws.[9]

[8] *See, e.g.*, *Vendors Join First Union in Its Electronic Mall*, Am. Banker, Aug. 11, 1995, at 9 (bank offering applications for credit cards on-line); Tracey Tucker, *Discount Mortgage Broker to Originate Loans On-Line Via Compuserve*, Am. Banker, July 27, 1995, at 16 (mortgage broker offering on-line mortgage loan brokerage services and anticipates soon offering other credit services, including credit cards).

[9] The OCC has recognized that technological developments increase access to banking services, including credit, for lower income individuals. *See* Eugene A. Ludwig, Comptroller of the Currency, *A Profitable Market Opportunity*, Remarks Before the Community Development Conference, OCC N.R. 96-21 (Feb. 23, 1996).

To be sure, there is a tension between the home state interest rule and the ability of a state to regulate the conduct of its citizenry, albeit conduct outside the state's borders. However, as *Marquette* recognized, the "protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court." 439 U.S. at 319. Congress, after *Marquette*, examined the wisdom behind Section 85 when it considered Sections 521-523 of DIDA and reaffirmed the primary importance of national competition by extending the home state interest rule to additional lenders.

II. THE CREDIT CARD INDUSTRY IS INTENSELY COMPETITIVE

Congress's efforts to promote national competition in the credit industries have been unambiguously successful in the credit card industry. In September 1995, the Board reported to Congress that competition in the credit card industry remains intense, with thousands of firms offering credit cards to consumers.[10] The Board found that the credit card industry has been characterized by growth, new entry, aggressive competition for new customers, and competitive pricing and profitability. FRB Report at 7-9. A number of governmental and academic economists who have studied competition in the credit card industry have reached the same conclusion.[11]

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[10] Board of Governors of the Federal Reserve System, "*The Profitability of Credit Card Operations of Depository Institutions*," An Annual Report Submitted to Congress Pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988, at 6 (Sept. 1995) ("FRB Report").

[11] *E.g.*, Baxter at 1014; Dagobert L. Brito & Peter R. Hartley, *Consumer Rationality and Credit Cards*, 103 J. Pol. Econ. 400 (1995) ("Brito & Hartley"); Loretta J. Mester, *Why Are Credit Card Rates*

In assessing the competitiveness of an industry, courts and economists generally focus on three factors: (1) the structure of the industry; (2) the conduct of firms in the industry; and (3) the economic performance of the industry. *See United States v. General Dynamics Corp.*, 415 U.S. 486, 501-06 (1974); F.M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 4-5 (3d ed. 1990) ("Scherer & Ross"). Measured against any of these indicia, the credit card industry is highly competitive.

A. The Industry Is Structurally Competitive

Economic analysis of industrial competitiveness generally begins with an examination of industry structure because, in the absence of industrial concentration, it is highly unlikely that firms will be able to act individually or collectively to lessen competition. Scherer & Ross at 71. *See also United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963). The Herfindahl-Hirschman Index (or "HHI") is the tool most commonly used to measure industrial concentration. Scherer & Ross at 72. Markets with an HHI of less than 1000 are considered by the Justice Department and the Federal Trade Commission to be "unconcentrated."[12] In studies of the credit

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Sticky?, 4 Econ. Theory 505 (1994) ("Mester"); Glenn B. Canner & Charles A. Luckett, *Developments in the Pricing of Credit Card Services*, 78 Fed. Res. Bull. 652 (Sept. 1992) ("Canner & Luckett"); Alexander Raskovich & Luke Froeb, *Has Competition Failed in the Credit Card Market?* (U.S. Dep't of Justice Antitrust Div. Econ. Analysis Group, Working Group Paper 92-7, June 12, 1992) ("Raskovich & Froeb"); Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, Yale J. on Reg. 201 (1986) ("DeMuth").

[12] U.S. Dep't of Justice and Federal Trade Comm'n, *Horizontal Merger Guidelines* § 1.5 (Apr. 2, 1992) ("DOJ/FTC Merger Guidelines") *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104; *see also* IIA Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* ¶ 404d at 18 (1995) (effects of industrial concentration on

card industry, courts and analysts have consistently found the industry to be "unconcentrated" and "atomistic," with an HHI of 564 or less.[13] *See SCFC ILC, Inc. v. VISA USA, Inc.*, 36 F.3d 958, 967-68 & n.13 (10th Cir. 1994) (HHI is below 500), *cert. denied*, 115 S. Ct. 2600 (1995).[14]

One of the principal reasons why the credit card industry is so unconcentrated is that there are "few barriers to entry for depository institutions that wish to issue credit cards." GAO Report at 25. Virtually any federally-insured bank, savings association, or credit union can join the MasterCard or VISA system and issue its own card. Indeed, since *Marquette*, the number of issuers has grown dramatically. "Approximately 4,500 of the 6,000 depository institutions that issue credit cards joined VISA and/or MasterCard between 1980 and 1991." *Id.*[15] Each of these institutions determines the specific

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profitability "seem generally to disappear once the share of the four leading firms falls below 50 to 55 percent or the Herfindahl falls below 1,000").

[13] Credit card issuers compete not only against one another, but also against other methods of payment, including proprietary credit cards (issued by department stores, oil companies and the like), debit cards, checks and cash. The HHI would be significantly lower if these competing payment methods were included in the calculus.

[14] *See also* U.S. General Accounting Office, *United States Credit Card Industry: Competitive Developments Need To Be Closely Monitored* 25 (April 1994) ("GAO Report") ("most analysts place the HHI value for the credit card industry at less than 564").

[15] Many of the recent entrants into the industry have been quite successful. For example, the Discover Card (launched in 1985) and the AT&T Universal Card (first offered in 1990) have become the third and sixth largest credit card programs, respectively, based on outstanding balances. *Top 50 Companies in Managed Bank Credit Card Loans*, Am. Banker, Sept. 11, 1995, at 33-34.

package of services it will offer, and independently sets the price and terms of its product offerings.

B. The Industry Is Characterized By Aggressive National Competition

Credit card issuers offer a wide array of credit card products. These products differ in both price and service dimensions, including annual fees, APRs, late fees, rebates or discounts on purchases, and a variety of other "enhancements," such as frequent flier miles and travel accident insurance. Credit card issuers compete aggressively against one another in each of these product dimensions, offering cards with different combinations of features designed to appeal to particular classes of customers. *See* Canner & Luckett at 654.

Although the Amicus Curiae Brief of Consumer Action argues (at 15-16) that average credit card APRs "have remained virtually constant at approximately eighteen percent" for several years, and that the "stability" of APRs on credit cards is the result of an absence of "market competition," neither claim is correct.

The average APR statistics cited by amicus Consumer Action conceal the vigorous price competition found in the industry today. This is because the statistics cited are calculated by taking the unweighted average of APRs charged by a sample of large banks to *some* of their customers; they "[do] not capture the diversity of interest rates that a typical issuer may offer its entire customer base," including lower fixed rate and variable rate plans. GAO Report at 15. In fact, the Board reported last fall that many credit card issuers, including nearly all of the largest issuers, have lowered APRs on many of their accounts. FRB Report at 7. A 1992 study by two Board economists observed that, of the 150 issuers studied, "[s]eventeen percent of the issuers . . . charged rates

below 16 percent per year. Nearly one-fourth offered variable-rate plans . . . [and] an additional 4 percent offered plans with a tiered rate structure, in most cases assessing lower rates on higher balances." Canner & Luckett at 654-55. The economists emphasized that, because the survey collected information about each issuer's largest plan (rather than all of its plans), "[u]ndoubtedly, the variety in the marketplace is even greater" than the survey suggests. *Id.*

The Board's 1995 report to Congress provides further evidence of the intense price competition among issuers. It observes that "[s]everal of the more rapidly growing firms in recent years . . . appear to have attracted market share by offering comparatively low-rate cards." FRB Report at 7. Other issuers, the Board notes, have competed by changing other price terms, "gain[ing] market share through co-branding and associated rebate strategies, typically combined with waivers of annual fees." *Id.*

Acknowledging the intensity of competition among credit card issuers, some analysts have argued that the supposed stability of APRs on credit cards presents an economic anomaly.[16] In a competitive industry, they contend, APRs should move in tandem with the cost of funds, yet they do not. As the Board observes, however, the fact is that APRs generally have become more responsive to the creditor's cost of funds, with about two-thirds of the card issuers basing their APRs on an index that moves with other borrowing rates. *Id.*

To be sure, a number of issuers still offer credit cards with fixed APRs. Economists at the Board, at the Department of Justice, and in academia, however, have studied why the APRs on these cards do not move in perfect correlation with

[16] *See, e.g.*, Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 Am. Econ. Rev. 50 (1991).

indices for other borrowing rates.[17] Their conclusion is that this alleged anomaly does not reflect a failure of competition. On the contrary, they explain, in a competitive market these rates should *not* move in tandem with changes in the cost of funds. The principal reason is that an estimated fifty to seventy-five percent of the cost of credit card operations is unrelated to the cost of funds, and thus does not change in response to changes in that cost. Baxter at 1016.

In addition to price competition, issuers vie for customers by offering enhanced features and services. *See* Robert H. Bork, *The Antitrust Paradox* 189 (1978) ("Product rivalry [is] a much more unstable and unsettling form of competition than price rivalry . . ."). For example, the Board notes that "MBNA continues to gain market share by its use of an aggressive affinity card marketing approach." FRB Report at 8. A study by Board economists likewise reports that, beginning in the mid-1980s, "many banks, especially those operating nationwide, became much more aggressive in marketing credit card accounts," including through "offering more card 'enhancements,' such as travel accident insurance, auxiliary rental car insurance, and other distinctive features that varied among issuers." Canner & Luckett at 654.

Millions of consumers have responded to this national competition by moving their account balances when offered more favorable features and terms. Issuers, as a result, are increasing the number of offerings they make available; "[m]ore than 2 billion direct mail solicitations were sent by issuers during 1994" alone. FRB Report at 8 n.12. These offerings frequently are accompanied by special incentives to switch. The Board reports that "many issuers have attempted to gain or maintain market share by offering very low,

[17] *E.g.*, Baxter at 1015-19; Brito & Hartley at 429; Mester at 505-07; Raskovich & Froeb at 11-12; DeMuth at 228-31.

temporary rates on balances rolled over from competing firms." *Id.* at 7. The AT&T Universal Card, for example, "attained top-ten status within months of its inauguration primarily by inducing switches from rival cards." Raskovich & Froeb at 1 n.1. The pace of consumer switching has accelerated in recent years. Indeed, during the first half of 1994 alone, "VISA cardholders transferred some $10.8 billion between issuers, almost six times more than during the same period in 1992." FRB Report at 8 n.12.

C. The Performance Of The Industry Reflects Its Competitive Structure

The economic performance of the credit card industry over the last decade reflects the intense competition described above. As this Court has observed, non-competitive industries tend to be characterized by restricted output, limited entry, and stable market shares. *See, e.g., National Collegiate Athletic Assoc. v. Board of Regents*, 468 U.S. 85, 106-07 (1984) (absent competition, "[p]rice is higher and output lower than they would otherwise be, and both are unresponsive to consumer preference"); *see also* DOJ/FTC Merger Guidelines § 2.1. The credit card industry, as even its critics acknowledge, has none of these characteristics.

The supply of credit available through credit card lending has grown dramatically over the last fifteen years. *See* Amicus Brief of Consumer Action at 6. As the GAO observes, before the 1980s, state usury laws "suppressed the growth of the credit card industry insofar as issuers in states with low [APR] ceilings issued cards only to the most creditworthy individuals." GAO Report at 12-13. This Court's decision in *Marquette* enabled issuers to expand the base of customers they served, leading to a significant surge in demand for credit card loans during the 1980s. *Id.* at 13. Indeed, the GAO found that "[t]he percentage of American households with at least one credit card grew rapidly during

the 1980s, from about 38 percent in 1977 to 54 percent in 1989." *Id.* The Board reports that this trend has continued unabated: "The aggressive competition for new customers during 1994 was at least partly the cause of a 19 percent increase from 1993 in the number of VISA and MasterCard [credit cards] in circulation, to a total of 341.3 million." FRB Report at 8.

New credit card offerings have come from established issuers and new entrants alike. These companies have fought vigorously with one another for credit card customers nationwide by offering a diverse array of products with different prices and features. This competition, in turn, "has led to substantial shifts in market shares among the industry's largest firms" over the past several years. *Id.* at 7. Where, as here, a national industry is characterized by rapid growth, significant new entry, price competition, innovative product offerings, and significant shifts among the industry leaders, there can be no doubt that it is functioning in a competitive manner.

Some doubts have been expressed, however, by critics of the industry who believe that the profits earned by credit card issuers are abnormally high. *See* Amicus Brief of Consumer Action at 13-14. Economists at the Board and at the Department of Justice, as well as a number of academic economists, have studied these allegations and rejected them.[18] Measured properly, rates of return on credit card operations are consistent with the rates of return earned by enterprises engaged in businesses of comparable risk.

To begin with, there is conflicting evidence on the question of whether the rates of return earned by credit card operations are, in fact, higher than those earned by other

[18] Baxter at 1018-19; Brito & Hartley at 429; Raskovich & Froeb at 11-12 & n.10; Canner & Luckett at 661-62.

enterprises. The Board's 1995 report to Congress on the profitability of credit card operations of depository institutions observes that, based on one set of time series data, "credit card operations have not been exceptionally profitable." FRB Report at 3. From 1974 through 1994, "the annual net earnings of bank credit card plans averaged 2.26 percent of balances outstanding," while "average net returns on other major types of bank lending have been quite similar: 2.42 percent on real estate mortgages, 2.26 percent on commercial and other loans, and 2.26 percent on installment loans." *Id.*

More importantly, the rates of return cited by the industry's critics are *accounting* rates of return. As Professor Baxter observes, however, "high accounting returns do not imply high economic profits." Baxter at 1018. With respect to credit card operations specifically, the use of this measure "tends to overstate the profitability of credit card operations relative to other lending services." *Id.* This is because credit card operations require the use of far more non-capital assets, such as marketing, advertising, and customer service. As an accounting matter, these expenditures are treated as expenses, not assets, and therefore are excluded from the base of "assets" on which the accounting rates of return are calculated. *Id.*; *see also* Raskovich & Froeb at 11 n.10.

Finally, as this Court has recognized, in a competitive industry the rate of return earned by a particular business will be commensurate with the level of risk incurred by that business. The higher the risk of an enterprise, the higher the return it must provide investors to attract capital. *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, 692-93 (1923). Credit card lending therefore "should be more profitable than other forms of bank lending because it is accompanied by greater risk." Baxter at 1019. In fact, economists who have carefully studied rates of return associated with credit card operations have concluded that, on

a risk-adjusted basis, these rates of return are consistent with those earned by other competitive enterprises.[19]

III. LOAN COMPENSATION MAY BE CALCULATED IN THE MANNER ALLOWED BY THE LAWS OF A NATIONAL BANK'S HOME STATE

Section 85 promotes national competition in the manner of calculating loan compensation, and not merely in the amount of loan compensation. Thus, this Court's decisions recognize that Section 85 applies to the method by which interest is calculated as well as the amount of interest.

Indeed, a fundamental policy underlying Section 85 is to protect national banks against unfriendly state laws regulating interest. *Tiffany v. Nat'l Bank of Missouri*, 85 U.S. (18 Wall.) 409, 412-13 (1874). Federal law would provide little, if any, protection to national banks if states could favor other lenders through the manner in which loan compensation is calculated. Section 85 therefore must incorporate as the federal standard not only the amount of loan compensation allowed by state law, but also the manner in which such loan compensation is calculated under state law. *See Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549, 555 (1900). Section 85, for example, incorporates state law relating to the compounding of periodic percentage charges, independent of state law limits on total loan compensation. *See Citizens' Nat'l Bank v. Donnell*, 195 U.S. at 374; *see also American Timber & Trading Co. v. First Nat'l Bank of Ore.*, 511 F.2d 980, 983 (9th Cir. 1973), *cert. denied*, 421 U.S. 921 (1975) (calculation on a 365/360-day basis).

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[19] Joseph F. Sinkey & Robert C. Nash, *Assessing the Riskiness and Profitability of Credit-Card Banks*, 7 J. Fin. Services Res. 127, 144 (1993); *see also* Brito & Hartley at 429; Canner & Luckett at 661-62; Raskovich & Froeb at 11-12 & n.10.

A. Late Fees Involve A Method Of Calculating Loan Compensation

Section 85 authorizes the collection of loan compensation at the "rate" allowed by state law. Thus, the laws of the state where the national bank is located govern whether loan compensation may be calculated, for example, using a one-time flat rate or a periodic percentage rate. *See Greenwood Trust Co.*, 971 F.2d at 824. Similarly, Section 85 incorporates state laws regarding *when* the rates for determining loan compensation may be applied: during the term of the loan (*i.e.*, as periodic percentage charges) and/or at delinquency (*i.e.*, as late fees).

Petitioner's argument that late fees are not covered by Section 85 fails to recognize that Section 85 incorporates state law on the permissible methods (rates) by which interest can be calculated. The OCC and case law recognize that interest includes loan compensation, and that late fees are loan compensation. Petitioner's claim essentially is that late fees are not covered by Section 85 because the manner in which the loan compensation is calculated is not covered by Section 85. But under the home state interest rule, the laws of the bank's state determine not only the amount of loan compensation, but also the manner of calculating the compensation, and thus the allocation of the compensation between the APR and late fees.

The fallacy of Petitioner's argument is illustrated by considering three price structures (or calculation methods) that a credit card issuer might adopt for cardholders who pay late: (1) the periodic percentage charge could be set at a higher rate at the time the loan is made on the basis of the cardholder's late payment history on other loans; (2) the periodic percentage charge for a loan could be increased after late payments on that loan; or (3) a fee could be assessed for each late payment, calculated on the late payment amount and

the delinquency period. In Petitioner's view, Section 85 draws an artificial distinction between these price structures and flat late fees. In fact, although these alternative calculation methods (rates) differ from a flat fee assessed upon late payments, they all are covered by Section 85.[20]

B. The Potentially Unworkable Hodgepodge Of State Laws

State laws that limit credit prices commonly impose comprehensive and interrelated limits on the permissible amount of, and methods of calculating, loan compensation.[21] A state thus may require all loan compensation to be included in periodic percentage charges and prohibit all other loan compensation. Another state may allow loan compensation through a combination of periodic percentage charges and up-front fees (*e.g.*, origination fees). Yet another state may allow flexibility in the price structure that can be offered, either with or without a limit on the amount of loan compensation.[22]

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[20] After Iowa challenged the ability of out-of-state banks to charge late fees in 1988, one credit card issuer merely converted the manner in which it calculated interest by imposing higher periodic percentage charges after late payment rather than late charges. *See* A. Joseph Newman, Jr., *Delaware Bank Finds Way to "Export" Card Fees*, Am. Banker, Aug. 31, 1988, at 2.

[21] *See, e.g.*, Pa. Stat. Ann. tit. 69, § 1906 ("the service charge shall include all charges incident to investigating and making" the credit card account, and "[n]o fee, expense, delinquency, collection or other charge whatsoever" may be collected if not provided for in the statute); N.J. Stat. Ann. 17:16C-50 (no "further or other amount for costs, charges, . . . expense, interest, discount, fees, fines, penalties or other things of value" are allowed unless expressly permitted).

[22] For example, a state may limit the amount of loan compensation by imposing a maximum yield calculated on an actuarial basis, and still allow the lender flexibility to adopt whatever price structure the lender chooses by which to receive that compensation.

Petitioner's argument that Section 85 incorporates only a portion of state law governing the manner of calculating loan compensation, if accepted, could render the statute unworkable. Some state laws limit the total loan compensation including late fees, *see, e.g.*, Wisc. Stat. Ann. §§ 421.301(20), 422.201(10m) (finance charges, which are limited under state law, may include late fees), while other states allow late fees only if periodic percentage charges are not imposed on loan balances that are paid late. *See, e.g.*, Mont. Code Ann. § 31-1-235. Petitioner suggests that a loan to a borrower in one of these states would be subject to the limit on late fees, but would not be subject to limits on periodic percentage charges. It would be difficult, however, if not impossible, to determine compliance with such an unintended and unpredictable patchwork of laws from the bank's state and the borrower's state.

Petitioner's reading of Section 85, if adopted, would adversely affect national competition in the credit card industry. The laws of the bank's state might provide for late fees to compensate for a relatively low periodic percentage charge, while the laws of the borrower's state might permit a relatively high periodic percentage charge and prohibit late fees. Petitioner's interpretation could result in the bank's charging a relatively low periodic percentage charge set by its state, but not being able to charge the late fee that the bank's state intended to compensate for the low periodic percentage charge. This could substantially disrupt the ability of the national bank to calculate loan compensation in the manner allowed by its home state laws, and thereby artificially restrain the bank's ability to compete with lenders in the borrower's state.

C. Choice Of Price Structures Furthers Efficient Pricing

The home state interest rule allows consumers to shop nationally for alternative price structures or methods of calculating loan compensation offered under the laws of various states throughout the nation. A consumer who lives in a state that allows periodic percentage charges but no late fees can choose a credit card account from a lender in a different state that allows late fees, thereby reducing the portion of loan compensation that is calculated through periodic percentage charges. Indeed, numerous pricing structures can be offered by national banks in states that do not restrict price structures for loan compensation.

These pricing alternatives provide significant benefits to consumers. Allowing consumers to choose the price structure under which they will pay loan compensation results in issuers' offering the most competitive pricing structures. Consumers are in the best position to determine whether they will be better off paying loan compensation on a periodic percentage charge basis or on some other bases. For instance, consumers who pay their account balances in full each month can choose credit cards with a price structure that has a higher component of the loan price attributable to periodic percentage charges and a lower annual fee because that structure is best for them. Consumers who carry a revolving balance on their accounts instead can choose a price structure that includes an annual fee and reduced periodic percentage charges.

The ability to choose a credit card with late fees benefits consumers by allowing issuers to offer lower APR products. Each of the thirty-one national credit card programs on the Bankcard Holders of America's list of low-cost credit cards, except one, includes a late fee to compensate for the low

APR.[23] Thus, issuers who cannot collect late fees will need to increase the APR or other fees to receive an appropriate level of gross revenues.

Late fees are a fair and efficient method of allocating the costs of operating a credit card program. Borrowers who pay late create operational costs directly attributable to their failure to comply with the terms of their agreements. Credit card issuers must adopt systems to track such behavior and respond to it appropriately. Individuals who pay late also present a greater credit risk than those who pay on time.[24] Lenders thus appropriately demand higher loan compensation for expenses and increased credit risk associated with late payment behavior.

Lenders may consider several different methods of calculating loan compensation to address this. The cost of credit might be increased at loan origination by identifying such behavior on other loans and imposing a higher periodic percentage charge or origination fee. Late fees do the same in

[23] *See* Bankcard Holders of America, *Bankcard Holders of America Low-Interest/No-Fee Credit Card List* (Feb. 1995).

[24] *See* Robert E. Litan, *The Economics of Credit Cards* at 7-8 (Jan. 1993) ("chargeoff rate of customers who at one point have been assessed a late fee has been between four and six times higher than credit losses on all accounts generally"); Edward C. Lawrence, L. Douglas Smith & Malcolm Rhoades, *An Analysis of Default Risk in Mobile Home Credit*, 16 J. Banking & Fin. 299, 311 (1992) ("[F]or loans that are several years old, the borrower's payment history is paramount in estimating default risk. This history is registered through the length of time that the loan has been in effect, the borrower's most recent delinquency status, and frequency of 30-day and 60-day delinquencies in the previous year"); *Meilink v. Unemployment Reserves Comm'n*, 314 U.S. 564, 567 (1942) ("It is common knowledge that interest rates vary . . . according to the hazard of particular classes of loans. Delinquent taxpayers as a class are a poor credit risk; tax default . . . is . . . a signal of distress").

a more efficient manner by imposing the higher cost in direct response to a late payment. Late fees are no less loan compensation covered by Section 85 merely because they are calculated in this manner.

Limiting the ability of issuers to charge late fees is inefficient because those individuals who cause the expenses and present the higher credit risks associated with such behavior cannot then be required to pay for the consequences of their conduct. Instead, lenders must increase loan compensation in another manner, such as by increasing the APR or annual fee. Many consumers who pay these other charges, however, pay on time. Forcing issuers to recover the costs created by late payers from *all* borrowers provides, in short, an economic subsidy for those who pay late. This inequitable result is exacerbated by the fact that the number of late payers increases as the cost to individuals of paying late decreases.

In sum, consumers are benefited, and the national competitive policies underlying Section 85 are furthered, if consumers can shop nationally for a wide variety of price structures on credit cards.

IV. PRICE CONTROLS LIMIT CREDIT AVAILABILITY AND HARM CONSUMERS

Contrary to Petitioner's suggestion that state limits on credit card late fees benefit consumers, such laws are detrimental to the very consumers whom these laws seek to protect. The intense national competition in the credit card industry efficiently sets the prices for credit by the free market principle of supply and demand. Externally imposed limits on the price at which credit is made available simply restrict the amount of credit that is available, particularly to those borrowers who have the most difficulty obtaining credit. *See*

generally Harold C. Nathan, *Economic Analysis of Usury Laws*, 10 J. Bank Res. 200 (1980) ("Nathan").

The home state interest rule does not restrict the ability of a state to limit the price of credit offered by local national banks. To the extent that the price structure for credit cards allowed by a state's law is desirable to consumers and acceptable to lenders, national banks located in that state will respond to the demand and offer a product at that price to customers who qualify. Similarly, national banks located in states with deregulated price structures will offer credit cards at a competitive price to creditworthy customers, even if not required to do so. Baxter at 1020-21.

A state law limit affects the marketplace where the law sets a price that is lower than the price at which lenders otherwise are willing to make loans to some borrowers. In that case, local national banks and those outside the state will determine that they are unwilling to extend credit at an artificially low price and will limit the availability of credit.[25] Credit cards will not be offered to those individuals who lenders determine are the highest credit risks. Canner & Fergus at 9 ("lower-income families and families headed by younger persons would seem to be among those most likely to be denied credit").

If lenders are constrained by state price limits, they would reallocate resources from those markets that do not allow a competitive return on investment to those that do. The result would be that some lenders would make fewer credit card loans and would increase the supply of other types of credit that are not regulated at artificially low prices. Alternatively, credit card issuers may choose not to make credit card loans

[25] DeMuth at 218; Baxter at 1021-22; Glen B. Canner & James T. Fergus, *The Economic Effects of Proposed Ceilings on Credit Card Interest Rates*, 73 Fed. Res. Bull. 1, 6-7 (1987) ("Canner & Fergus").

to borrowers who reside in states that impose artificially low price limits, resulting in the balkanization of credit availability, in direct conflict with the national competition envisioned by Congress and *Marquette*.[26]

Permitting the borrower's state to impose artificial limits on the availability of credit cards is especially undesirable because, in today's marketplace, the credit card is an important payment device. Credit cards can be virtually indispensable in many common transactions, such as renting a car, making a purchase by mail or telephone, or guaranteeing a hotel room for late arrival. Consumers who use a credit card to make multiple purchases during a month at numerous establishments conveniently receive a single statement itemizing all of those purchases. State laws that effectively restrict the availability of credit cards to less creditworthy consumers deprive those consumers of these important benefits.

V. SECTION 85 INCREASES THE EFFICIENCY OF PROVIDING CREDIT CARD SERVICES

Application of the home state interest rule in place of multiple state interest rules increases the efficiency of credit card issuers that compete nationally. Issuers are able to provide credit services more efficiently if they offer their products under a single federal interest law rather than having to comply with numerous different and often conflicting state laws on loan compensation. These efficiencies are passed

[26] DeMuth at 241-42 ("The benefits of increased competition would be lost if . . . interest rate controls . . . [resulted in] the withdrawal of card programs to state and local markets"); Nathan at 209 ("[U]sury ceilings . . . . cause severe economic distortions that extend far beyond the market they were intended to regulate. The major example of distortion is inefficient resource allocation between states.").

along to credit card customers in the form of lower prices or higher-quality services.

Petitioner argues that a credit card issuer competing nationally should have to adopt a different price structure in each of the states in which it has customers. That would mean issuers would have to comply with a myriad of individual state laws regarding late fees. These state laws many times do not simply provide for a permissible flat dollar amount, but also vary the permissible amount of late fees periodically with changes in the Consumer Price Index, and impose different grace periods before a late fee may be imposed.[27] For those issuers that desire to offer a uniform program nationwide, the requirement of complying with the laws of all states through the "lowest common denominator" essentially prevents the assessment of any late fee.

The complexity of individual state price limits increases exponentially if, as Petitioner's argument suggests, other credit card fees recognized by the OCC as interest are not covered by Section 85. For example, card issuers could be forced to adopt state-specific pricing with respect to annual fees and overlimit fees. The state laws governing these fees likewise are not limited to simple numerical amounts. Some states set rules on the refundability of annual fees, or on how far over limit an account must be before an overlimit fee can be assessed.[28] In a national credit card program, variations in

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[27] *See, e.g.*, Ind. Code § 24-4.5-3-203.5 and Okla. Stat. Ann. tit. 14A, § 3-203(5) (fees vary with CPI); Cal. Fin. Code § 4001(a)(1) ($7 if payment is 5 days late, $10 if 10 days late, or $15 if 15 days late).

[28] *See, e.g.*, Mass. Gen. L. ch. 140 § 114C (annual fee); Cal. Fin. Code § 4001(a)(3) (overlimit by $500 or 120%, whichever is less); S.C. Code Ann. § 37-3-202(1)(c)(ii) (no second overlimit fee unless account balance reduced to the lesser of 10% or $100 below credit limit and then increased to the lesser of 10% or $100 above credit limit).

state laws such as these would create enormous operational burdens.

There are several implications of subjecting national credit card issuers to this level of state price control. From the legal compliance standpoint, it requires card issuers initially to determine the relevant state law limits through review of state statutes, regulations, interpretive letters and cases. In the highly technical consumer credit area, this undertaking is substantial in a single state, let alone a large number of states. Issuers also must continuously monitor statutory, regulatory, and other developments in the laws of various states, and adapt their programs accordingly. Such compliance efforts, while not impossible, are tremendously expensive for issuers and consumers.

Complicated operational issues also need to be addressed. The computer systems used for billing on the accounts need to be programmed to reflect all of the individual state variations. Different forms of agreements are needed for different states, or complicated forms showing the relevant fees for residents of the various states are necessary. Changes in these state law-specific systems and agreements are required when a consumer moves to a different state. Customer service representatives answering questions from on-line data systems need to know the particular state fee structure applicable to each cardholder.

A likely consequence of this burden would be that fewer issuers would be able to compete nationally. Card issuers would not have the nationwide market in which to achieve the economies of scale that have assisted the development of large credit card programs. Evans & Schmalensee at 28-29. Similarly, issuers would need to adopt particular underwriting and credit policies based on the price structures of their home state that must be revised if pricing structures vary between states. The added complexity of state-by-state price

regulation will benefit only the lawyers and other service providers who will be needed to develop and maintain the compliance structure necessary for the additional regulatory burden.

In sum, Petitioner's theory, if adopted, would result in fewer credit card issuers, higher interest charges, and less consumer choice, thereby undermining the very purposes of Section 85.

CONCLUSION

Petitioner's interpretation of Section 85 is inconsistent with the national competition that was envisioned by Congress and recognized by *Marquette*, and would not benefit consumers. The decision of the court below thus should be affirmed.

Respectfully submitted,

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No. 95-860

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,
v.
CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On Writ of Certiorari to the
California Supreme Court

BRIEF FOR *AMICI CURIAE* AFFINITY GROUP MARKETING AND CREDIT UNION NATIONAL ASSOCIATION, INC. IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI* [1]

Affinity Group Marketing ("AGM") is a closely-held corporation in the business of developing and marketing affinity credit card programs. AGM is the developer of an affinity card program for the American Federation of Labor-Congress of Industrial Organizations ("AFL-CIO"),

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[1] Pursuant to Supreme Court Rule 37.3, copies of letters from Counsel for Petitioner and Counsel for Respondent consenting to the filing of this brief have been filed separately.

generally referred to as the Union MasterCard Program. The Union MasterCard Program is a joint program of AGM, The Bank of New York (Delaware), and Union Privilege, AFL-CIO (a subsidiary of the AFL-CIO that provides benefit programs for members of AFL-CIO affiliated labor unions).

The credit cards issued under the Union MasterCard Program are available to members of AFL-CIO affiliated labor unions and their families. Approximately 3,300,000 union members and their families throughout the nation have credit cards issued under this program, with more than $3.5 billion in currently outstanding balances. The Union MasterCard is offered on terms that are specially designed and negotiated for members of AFL-CIO affiliated labor unions. For example, the variable finance charge rate is low, and members are allowed to skip a specified number of monthly payments during a union-sanctioned strike and/or for certain fixed months during the year. The Union MasterCard terms include a late charge of $15.

Credit Union National Association, Inc. ("CUNA") is the principal national trade association for credit unions in the United States. It consists of 51 credit union leagues covering the fifty states and the District of Columbia. About 90 percent of the approximately 12,350 federal and state-chartered credit unions in the United States are members of these CUNA leagues. CUNA represents the interests of these credit unions in legislative and regulatory matters. CUNA and its affiliates also provide a wide range of support services to credit unions, including credit card processing and support for approximately 2,300 credit unions with almost five million credit cardholders. Credit unions affiliated with CUNA are owned by their member-customers, whose elected representatives set the credit unions' rates of charge for credit cards and other services.

Amici have a substantial interest in the issue to be decided in this case. Union MasterCard's credit card terms include late charges, which are authorized under federal banking law[2] and the laws of the state where the issuing bank is located. The card programs of many of the CUNA-affiliated credit unions also include late charges.[3] These institutions charge late fees to delinquent borrowers because doing so allows the institutions to charge lower monthly finance charges to members who pay on time.

Amici believe that Petitioner, who has admittedly paid late in violation of her credit card agreement, and who seeks to represent the small minority of other credit cardholders who pay late, does not accurately reflect the interests of consumers generally. *Amici*, who represent large and diverse membership groups, believe that their policies reflect a fair view of the interests of the vast majority of credit cardholders. They believe that lenders whose home state laws permit late charges should continue to be able to offer cardholders the choice of credit cards with low finance charges coupled with late fees, thereby allocating costs of delinquency more appropriately to those borrowers whose conduct imposes higher costs on the system. *Amici* believe that the applicable federal

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[2] The Bank of New York's charges are governed by 12 U.S.C. § 1831d, which was modeled on, and is nearly identical to, 12 U.S.C. § 85 ("Section 85"). *See, e.g., Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 826-27 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 12, 1993), *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,635 (Opinion No. 93-27); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 8, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (Opinion No. 92-47).

[3] The loan charges of state-chartered, federally-insured credit unions, which constitute about half of CUNA's members, are governed by 12 U.S.C. § 1785(g), which is also nearly identical to 12 U.S.C. § 85. Letter from Richard S. Schulman, NCUA Acting Associate General Counsel (Apr. 11, 1994), *reprinted in* 62 Banking Rep. (BNA) 766 (Apr. 25, 1994).

laws do not allow such lenders to be subjected to regulatory limits on such charges imposed by other states where borrowers may live or use their cards.

SUMMARY OF ARGUMENT

Card issuers such as *Amici* Issuers[4] should be free to offer their cardholders or members credit cards with a package of pricing terms that minimizes the costs to those borrowers who meet their payment obligations on time. They should be free to impose the additional costs associated with delinquencies on those customers responsible for the costs associated with late payment, especially since the erratic payment histories of those cardholders who fail to meet agreed-upon payment deadlines indicate that they pose a greater risk of nonpayment. As long as the laws of their home states permit such pricing packages, *Amici* Issuers should not be forced to modify their otherwise uniform, nationwide credit plans to accommodate the varying laws of states where their borrowers live or shop.

The term "interest" in the applicable federal laws encompasses all the terms of credit card pricing packages that constitute "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873). Late payment fees meet this definition, and should be treated as "interest" under federal law, thus permitting lenders like *Amici* Issuers in states whose laws allow such charges to impose them in order to reduce the cost of credit to borrowers who pay on time.

An artificially narrow interpretation of "interest" that excluded late charges would undermine the national lend-

[4] As noted above, AGM is associated with the Union MasterCard Program, which The Bank of New York issues from Delaware. CUNA-affiliated credit unions issue credit cards from all fifty states. For purposes of simplicity, we refer herein to the issuers of all of these various credit card programs as "*Amici* Issuers."

ing market that Congress sought to foster when it enacted 12 U.S.C. § 85. *See Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978). For the national financial market to prosper, it is crucial to financial institutions like *Amici* Issuers that the "exportation" principle described by the Court in *Marquette* apply to all lending charges, not just the periodic percentage rate. The Union MasterCard Program and many CUNA-affiliated credit unions have established credit card programs specifically designed to provide members with uniform, non-discriminatory terms nationwide. Many of the smaller institutions, which have credit card programs serving people spread over a large number of states, could not continue to operate if they had to conform their charges to the requirements of every state.

In establishing their card programs and pricing packages, *Amici* Issuers have relied on the guidance of their regulators, who have advised the industry for years that the term "interest" in the statutes they administer includes late charges and other similar elements of credit card pricing packages. This administrative guidance, and reliance on it, is entitled to substantial weight in interpreting the banking statutes.

ARGUMENT

I. "INTEREST" INCLUDES THE ENTIRE PACKAGE OF LENDING CHARGES AGREED TO BY LENDERS AND BORROWERS.

Like Citibank, AGM's Union MasterCard Program and CUNA-affiliated credit unions collect different kinds of charges under their credit card programs that, together, form a package that compensates them for the use, forbearance, or detention of their money. For example, AGM's Union MasterCard Program is able to offer cardholders a low periodic finance charge and the right to defer payments under certain circumstances, in part because it recoups costs associated with delinquency

through a late charge levied on cardholders who do not make payments on the dates when they are required. The various credit union affiliates of CUNA offer a variety of lending packages similarly tailored to their particular needs and those of their members, many including late fees. In *Marquette*, this Court recognized the existence of these packages and the tradeoffs they involve for both the lender and the borrower. 439 U.S. at 302-03.

The late charges in these packages are not, of course, designed to collect from each delinquent borrower the precise share of cost he or she imposes on the system; that would be wholly impractical. But they are designed to reflect these costs in packages that will be attractive to the members of these groups.

There is no reason to distinguish, for purposes of regulatory jurisdiction, among the lending charges in these packages, with the consequence that some of the lending charges are governed by one set of laws (federal and the financial institution's home state) and others are governed by various other sets of laws (including all the states in which borrowers reside or shop). All of the charges in these packages constitute "interest" as that term is generally understood in the law. Indeed, the classic definition of "interest," expressed by this Court more than a century ago, is all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention."[5]

Moreover, as an economic matter, there is no reason to distinguish among various loan charges, which are different parts of the total compensation the lender receives

[5] *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873); *see also Shoemaker v. United States*, 147 U.S. 282, 321 (1893) ("Interest accrues either by agreement of the debtor to allow it for the use of money, or, in the nature of damages, by reason of the failure of the debtor to pay the principal when due.").

for making loans. If financial institutions are unable to recover their costs and earn a profit through certain kinds of charges, they must increase other charges in order to achieve the same level of compensation. The same body of law should govern all of these mechanisms by which financial institutions are compensated for their loans, including late charges.

II. LATE CHARGES ARE A FAIR AND EFFICIENT WAY TO ALLOCATE THE COSTS OF DELINQUENCY TO CARDHOLDERS WHO PAY LATE.

The late charges at issue here are appropriate ways to allocate certain costs of credit to those customers who impose the costs on the card system. Petitioner and other members of the purported class failed to make minimum payments by the days specified in contractual agreements they entered into. Although Petitioner and her lawyers paint themselves as representatives of all cardholders and argue that late charges are contrary to the interests of all of them, this is not correct. As one distinguished economist has put it:

> Prohibitions on late charges fail to protect consumers. Instead, they "protect" people who pay late by making such behavior costless. Indeed, more people will pay late if there is no cost to them personally. However, there is a cost associated with late payments, and this is borne by the credit card users who honor their agreements. What these prohibitions do, then, is to subsidize those who pay late at the expense of those who pay on time. . . . That is not a desirable outcome if "the greater good" is what we hope to achieve.

William C. Dunkelberg, *Litigation Concerning Late Charges Is Major Threat To Credit Card Business*, Banking Pol'y Rep., Apr. 6, 1992, at 1, 16 (available on LEXIS).

Failures to make payments by their agreed due dates impose several different costs on the lender. First, the

delinquency lengthens the loan, and longer-term money generally costs more than short-term money. Robert E. Litan, *The Economics of Credit Cards* 7 (1993). Second, delinquency imposes increased costs of loan administration and tracking. *Id.* Third, the lender has costs for collection machinery. Finally, delinquent borrowers are more likely to become defaulting borrowers:

> When a customer is late in making his or her required minimum payment, that action is a signal to the issuer that the customer is much more likely to default on the entire balance than customers who pay on time. . . . [D]ata show that the chargeoff rate of customers who at one point have been assessed a late fee has been between four to six times higher than the credit losses on all accounts generally.

Id. (emphasis omitted); *accord* William F. Baxter, *The Economic Benefits of Federal Preemption and Deregulation of the Credit Card Industry*, 1995 Utah L. Rev. 1009, 1025 (forthcoming). To compensate for these increased risks and costs, a financial institution must either charge late fees of some sort or raise some other charge, such as the monthly finance charge on all balances. The vast majority of *Amici* Issuers' cardholders (for example, 97.62% in the Union MasterCard Program) either do not incur late charges and similar charges or do so only rarely, and it is unfair that they should pay higher monthly finance charges in order to subsidize those members whose payment patterns make them subject to late charges. *See* Robert E. Litan, *supra*, at 8 ("It is also fair and efficient to charge a fee to cover the increased risk of nonpayment. To do otherwise—that is, to spread the costs of collecting on their late accounts among all card users—would be to penalize the timely-paying customers.").

It is also appropriate and practical to state late charges as flat amounts rather than percentages. Flat amounts are often clearer and more easily understood by customers. Moreover, the extra costs that delinquent borrowers impose are *not* proportional to the amount that is late, and because of the small size of many credit card delinquencies, a percentage that is sufficient for a small delinquency would be too high for a larger amount.

For these reasons, early in the development of the Union MasterCard Program, the AFL-CIO decided that flat late charges would be part of the program's credit card terms, in order to keep the monthly finance charge for on-time members as low as possible. Similarly, many credit unions—nonprofit organizations that are owned by their customers and set their prices to meet member needs—include late charges in their price terms in order to keep the ordinary monthly finance charges down and allocate costs fairly.

III. IT IS IMPORTANT THAT FINANCIAL INSTITUTIONS BE ALLOWED TO CONTRACT FOR FEES ON A UNIFORM BASIS NATIONWIDE.

Section 85 authorizes the "exportation" of "interest" rates. That is, a bank may properly charge the rates allowed by its home state to everyone who chooses to do business with it, even if the cardholder resides in a jurisdiction that imposes a lower ceiling or different restrictions on lenders within its jurisdiction. Contrary state law "must, of course, give way." *See Marquette*, 439 U.S. at 318 n.31. This principle applies to all aspects of the financial institution's "interest" charges, including late fees.

It is critical to nationwide credit card programs, such as the Union MasterCard Program and the programs of many of the CUNA-affiliated credit unions, that they not be required to discriminate against some cardholders by offering them different terms because of where they happen to live or shop. For example, the Union MasterCard Program was developed and negotiated based upon the strength of the over 13½ million members of the AFL-CIO affiliated unions taken as a group. Because the

finance charge, late charge, and other charges are interrelated, if different late charge restrictions were applied in different states, members in one state might well end up subsidizing members in another state. A cardinal rule of labor relations is the equal treatment of people, and it would break a bond of fellowship among union members if the members in different states had to be charged different rates for money that comes from the same source. It would likewise be inappropriate for a credit union to be required to discriminate in its pricing terms between members, who all have the same ownership and voting rights in the institution, merely because some of them live in a different state.

Requiring these credit card issuers to differentiate among cardmembers based on where they reside would seriously undermine their national credit card programs for an additional reason. The membership bases of many of these institutions are widely dispersed across the United States and the world, and they are highly mobile. If the institutions were required to conform their late charges and other charges to the rates specified by the local laws of each jurisdiction where customers reside or shop, and to adjust those terms when customers change residences or shop in a different state, the administrative costs (including legal costs, computer costs, accounting costs, marketing costs, costs of maintaining many different sets of standard contracts, and training costs for account service personnel) would be very substantial. These costs would be particularly onerous for a small credit union, which does not have a large membership base over which to spread the costs.

This Court made clear in *Marquette* that the purpose of 12 U.S.C. § 85 was to create a "national" financial market for financial institutions and their customers. If a customer is unable to obtain credit on the most favorable terms from lenders in his or her own jurisdiction, Congress intended not only that the customer could borrow

from a financial institution in a different jurisdiction, but also that he or she could borrow on the terms allowed by the law of the financial insitution's state. *Marquette,* 439 U.S. at 314-19. This Congressional design fosters interstate competition among financial institutions and increases the variety of options available to customers. A customer is always free to deal with a local institution at rates set by local law, but the intent of the federal banking laws is to allow borrowers the alternative of dealing with lenders governed by other states' rate restrictions instead.

Excluding late charges from the scope of the term "interest" in 12 U.S.C. § 85 would undermine the practical effect of the decision in *Marquette* even as to a financial institution's monthly finance charge ("APR"). As noted above, late charges are a material financial term on a credit card account and can have a significant impact on the level at which the APR is set. Thus, for example, a low-APR lender would need to consider adjusting its APR in some or all jurisdictions in response to any limits on its late charges. Such state-by-state adjustments would not serve the interests of the financial institution or its non-delinquent cardholders, and they would run counter to the principles underlying *Marquette*. Therefore all aspects of the price that cardholders pay for credit—whether it is the monthly finance charge, late charge, or other charges —must be recognized as part of the "interest" package that the financial institution is authorized to charge.

IV. FINANCIAL INSTITUTIONS HAVE JUSTIFIABLY RELIED ON THE LONGSTANDING OPINIONS OF THEIR REGULATORS.

The terms of the Union MasterCard credit card program, and those of CUNA's affiliates and other financial institutions, have been established in reliance on longstanding regulatory interpretations of the federal banking laws issued by the federal bank regulatory agencies. As

Respondent describes in its brief, those legal interpretations are entitled to substantial judicial deference.

Late charges for delinquent payers are not a recent innovation. The Office of the Comptroller of the Currency ("OCC") opined as early as 1955 that late charges on consumer accounts are governed as "interest" by 12 U.S.C. § 85 (Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955)), and it reiterated the point again last year (Letter from Julie L. Williams, OCC Chief Counsel (Feb. 17, 1995), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618 (Interpretive Letter 670)). Most recently, the OCC issued a regulation, after notice and comment, codifying the principle. 61 Fed. Reg. 4849 (1996) (to be codified at 12 C.F.R. pts. 7 and 31). The other federal banking agencies, construing almost identical statutes governing other types of financial institutions, have over many years consistently reached the same conclusion.[6]

Here is an important instance in which federal law has been very clearly and explicitly spelled out by the appropriate agencies for the guidance of an industry and organizations such as *Amici* Issuers. Their programs have been established in reasonable reliance on those agency interpretations, and the specific terms of their accounts

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[6] *See, e.g.*, Letter from Karen Solomon, OTS Deputy Chief Counsel (Sept. 29, 1994), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,852 (Opinion No. 94/CC-18) (thrifts); Letter from Douglas H. Jones, FDIC Deputy General Counsel (July 8, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,534 (Opinion No. 92-47) (federally insured state-chartered banks); Letter from Harry W. Quillian, FHLBB Acting General Counsel (June 27, 1986), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,852, at 62,403 (thrifts); Letter from Richard S. Schulman, NCUA Acting Associate General Counsel (Apr. 11, 1994), *reprinted in* 62 Banking Rep. (BNA) 766 (Apr. 25, 1994) (credit unions).

are clearly stated in the agreements given to each cardholder with his or her credit card. Much has been staked on this guidance. These legitimate reliance interests in financial affairs should be given substantial consideration. *See, e.g., Zenith Radio Corp. v. United States*, 437 U.S. 443, 457-58 (1978) ("In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.' " (citations omitted)).[7]

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be affirmed.

Respectfully submitted,

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[7] Petitioner's reliance on *Harper v. Virginia Department of Taxation*, 113 S. Ct. 2510, 2516 n.9 (1993) (Pet. Br. at 48), is misplaced. The issue that the Court addressed in the footnote Petitioner cites involved the retroactive application of " 'a new principle of [constitutional] law,' " *id.* at 2516 (citation omitted), not the deference owed to an agency interpretation on which an industry has relied for many years.

(15)

No. 95-860

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

ON WRIT OF CERTIORARI TO THE CALIFORNIA SUPREME COURT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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Pursuant to Rule 37.3 of this Court, The New York Clearing House Association (the "Clearing House") respectfully submits this brief as *amicus curiae* in support of Respondent Citibank (South Dakota), N.A. ("Citibank") with the consent of all parties.

Interest of *Amicus Curiae*

The Clearing House is an association of eleven leading commercial banks in the City of New York, including an affiliate of Citibank.[1] The Clearing House regularly appears as *amicus curiae* in cases raising important issues relating to banking, and its members have a common and vital interest

[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, NatWest Bank National Association, European American Bank and Republic National Bank of New York.

in the consistent and uniform application of the banking laws of this country.

The issue raised in this appeal concerns state efforts to regulate credit card late charges assessed by national banks. Four members of the Clearing House are national banks governed by the National Bank Act (the "Act") and supervised by the Office of the Comptroller of the Currency ("OCC"), a bureau within the Department of the Treasury. 12 U.S.C. §§ 21 *et seq.*[2] Under Section 30 of the Act, codified as 12 U.S.C. § 85 ("Section 85"), a national bank is permitted to charge "interest" to its customers — wherever located — at the highest rates authorized by the bank's home state. The other seven members of the Clearing House are state-chartered banks governed by a statutory provision modeled after Section 85 — Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1831d (1994) — that grants state banks the same authority as Section 85 grants national banks.

The sole issue in this case is whether Section 85 should be interpreted — contrary to the consistent position of the OCC — to exclude from the definition of "interest" the late payment charges for loans that are typically included in credit card agreements. The Clearing House's member banks have relied on the OCC's interpretations in structuring their credit relationships with customers for years, and would face a substantial burden if forced to vary the financial terms of their credit card programs to comply with the different late charge regulations imposed, from time to time, by the 50 states. In addition, the banks could no longer offer credit card programs on a uniform national basis.

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[2] The OCC was created in 1863 by the National Currency Act, ch. 58, § 1, 12 Stat. 665-66 (1863), and given the power to regulate national banks in both that statute and the National Bank Act, ch. 106, § 1, 13 Stat. 99-100 (1864).

Summary of Argument

The decision below affirmed the consistent interpretation of Section 85 adopted for many years by the OCC — the regulatory agency charged with supervision of national banks — and the courts that "interest" includes late charges. (*See* A 26-28.)[3] This interpretation is consistent with Congress's objective in adopting the Act as a whole and Section 85 in particular.[4]

Congress adopted the Act to establish a strong national banking system which could provide credit across state lines free of state-law impediments. This objective was a product of the Civil War: both because (1) the war created a critical need for a stable and strong national banking system capable of financing the war effort and (2) many fewer opponents of federal fiscal power were in Congress after the Southern states seceded from the Union. Knowing the potential for hostile and inconsistent state regulation, Congress adopted a uniform regulatory scheme governed exclusively by federal law.[5]

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[3] Citations to the decision below, in the form "A __," are to the appendix to the petition for certiorari.

[4] Subsequent to the decision below, the OCC, in accordance with the procedures of the Administrative Procedure Act, adopted a regulation reaffirming its prior interpretations of Section 85. *See* 61 Fed. Reg. 4849, 4869 (1996) (to be effective on April 1, 1996 and codified at 12 C.F.R. § 7.4001).

[5] Although Section 85 adopts the most favorable rate allowed to *any lender* by a national bank's home state as the highest rate the bank may charge, a national bank's lending charges are governed solely by federal law, *i.e.*, Section 85 does not permit any concurrent state regulation of national banks' lending charges nor does it involve a delegation of federal authority over national banks to the states. Thus, a national bank's home state may *not*, by statute or otherwise, impose a lending rate on national banks that is lower than the rate prescribed by Section 85 nor provide *any* remedies for breaching either Section 85 or a state-imposed lending limit

(continued...)

The OCC's definition of interest under Section 85 as including late charges is consistent with the historic use of "interest" to encompass a broad range of loan-related charges. This is apparent in academic materials, dictionaries and judicial opinions from the mid-nineteenth century and before, as well as the established banking practices of the time. Moreover, a federal definition of interest which includes late charges is consistent not only with the prevailing understanding of the word interest at the time of the Act's enactment, but with Congress's intent to provide a strong banking system of national scope.

ARGUMENT

Section 85 authorizes national banks to charge "interest at the rate allowed by the laws of the State . . . where the bank is located." 12 U.S.C. § 85. There is no dispute that this provision authorizes a national bank to impose periodic percentage interest charges on a customer's outstanding credit card balance to the extent permitted by the national bank's home state. The question in this case is whether delinquency charges — that is, the amount charged to a borrower because the borrower fails to repay amounts due on time — constitute "interest" governed by this provision.

The briefs of the parties examine at length the authorities interpreting Section 85. They show that Section 85 has been repeatedly applied by the courts, and by the OCC, to all of the charges received by a bank as compensation for lending, however denominated. Moreover, recent judicial determinations have also held that Section 85 applies to credit card late fees.[6]

[5](...continued)
— the exclusive remedies for overcharging by a national bank are provided by 12 U.S.C. § 86 ("Section 86"). *Farmers' & Mechanics' Nat'l Bank* v. *Dearing*, 91 U.S. 29 (1875). *A fortiori*, Section 85 does not permit concurrent regulation by the home state of a national bank's borrower.

The historical analysis which is the focus of this brief demonstrates that these decisions are fully consistent both with Congress's goals in passing the Act and with the use of the term "interest" at the time of the Act's adoption.

I. The National Bank Act Was Enacted by Congress To Provide for a Uniform Currency and an Interstate Lending System Administered Through a Strong National Banking System.

Congress passed the Act in 1864, in the midst of the Civil War, in order to provide for a strong national banking system. Such a system required federally chartered banks that could provide a uniform currency and participate unfettered in interstate lending. At the time, Congress knew from experience that powerful political forces existed at the state level that would seek to protect local state-chartered banks and to undermine the effectiveness of out-of-state federally chartered banks. The Act was designed, in part, to prevent this frustration of Congressional purpose by the states. Section 85 was specifically aimed at (1) protecting national banks from discrimination in favor of state-chartered banks and (2) state interference with national banks' ability to engage in interstate commerce through balkanized regulation of lending charges.

[6] *See, e.g.*, *Greenwood Trust Co.* v. *Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993); *Copeland* v. *MBNA America Bank, N.A.*, 907 P.2d 87 (Colo. 1995). The only appellate courts to have reached the opposite conclusion are the New Jersey Supreme Court (by a 4-3 division), and the Pennsylvania Superior Court (by a 6-3 vote). *See Sherman* v. *Citibank (South Dakota), N.A.*, 668 A.2d 1036 (N.J. 1995); *Mazaika* v. *Bank One, Columbus, N.A.*, 653 A.2d 640 (Pa. Super. Ct. 1994), *appeal granted*, 659 A.2d 557 (Pa. 1995); *see also Gadon* v. *Chase Manhattan Bank, (USA)*, 653 A.2d 697 (Pa. Super. Ct.) (following *Mazaika*), *appeal granted*, 659 A.2d 557 (Pa. 1995).

A. The Civil War Provided Both the Need and Political Opportunity for a National Banking System.

Prior to 1864, the nation's banking system was a "decentralized, unstable structure of state banks" with frequent failures and under which there was no uniform federal currency.[7] In the absence of federal involvement, banking was a function of disparate state regulation.[8] The economy was hampered not only by an often loose state chartering and regulatory approach, which resulted in frequent bank failures, but also by the absence of a national form of paper currency. The ability of businesses to engage in interstate commerce in an efficient manner was undermined by a haphazard system of privately issued bank notes of uncertain and varying value, especially when transactions involving those notes occurred in locations remote from the issuing bank.[9]

Congress had earlier established the First and Second Banks of the United States to address these problems.[10]

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[7] JAMES M. MCPHERSON, BATTLE CRY OF FREEDOM 594 (1988).

[8] *See* David M. Gische, *The New York City Banks and the Development of the National Banking System, 1860-1870*, 23 AM. J. LEGAL HIST. 21, 24-25 (1979).

[9] *See id.* Representative Samuel Hooper, chief sponsor of the Act in the House of Representatives, decried that a nation "which leaves the power to regulate its currency to the legislation of thirty-four different states abandons one of the most essential attributes of its sovereignty." BRAY HAMMOND, SOVEREIGNTY AND AN EMPTY PURSE 314 (1970) [hereinafter HAMMOND, SOVEREIGNTY] (quoting from debates on the National Currency Act of 1863).

[10] *See Treasury Report on a National Bank* (Dec. 13, 1790), *in* 1 DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES 230, 233-34 (Herman E. Kross ed. 1969) [hereinafter KROSS]; *Opinion of Alexander Hamilton, On the Constitutionality of a National*
(continued...)

Those Banks were short-lived, however, falling victim to the ongoing political struggle between advocates of a strong central government (primarily the industrial and commercial interests in the North) and advocates of "states' rights" (primarily in the South and West). *See* SISTER M. GRACE MADELEINE, MONETARY AND BANKING THEORIES OF JACKSONIAN DEMOCRACY 8-9, 11 (1943) [hereinafter BANKING THEORIES].

The First Bank of the United States was established by Alexander Hamilton and the Federalists in 1791, over the strong opposition of Thomas Jefferson, James Madison, and other Jeffersonians generally fearful of a strong national government. When the Jeffersonians gained power in 1801, the Bank again became a political issue, with the states opposing the Bank's domination of credit throughout the country. Although the Bank had proved to be an "unqualified success," President Madison and his supporters in Congress permitted the Bank's charter to expire in 1811. *See id.* at 6-12.

Shortly after the First Bank's demise, financial chaos resulted from the rapid multiplication of small independent state banks. *Id.* at 12-15. This led Congress to establish the Second Bank of the United States in 1816. *See* Act of April 10, 1816, ch. 44, 3 Stat. 266. But the aggressive expansion of the Second Bank caused many states — particularly those in the South and West — to enact legislation "designed to cripple the activities of the 'Chestnut Street Monster' and to destroy its power within their jurisdictions." BANKING THEORIES, *supra*, at 21. Some states enacted constitutional amendments to prohibit the Second Bank from operating within their jurisdictions; other states tried to impose

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[10](...continued)
Bank (Feb. 23, 1791), *in* LEGISLATIVE AND DOCUMENTARY HISTORY OF THE BANK OF THE UNITED STATES 95, 108 (M. St. Clair Clarke & D.A. Hall ed. 1967) (1832); *Recommendations from Secretary of the Treasury Alexander Dallas on a National Bank* (Oct. 17, 1814), *in* KROSS, *supra*, at 396-97.

prohibitive taxes. *Id.* at 21-22. A Maryland statute imposing a heavy stamp tax on all notes issued by banks incorporated outside the state led to this Court's decision in *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819), declaring such state taxes unconstitutional.[11]

Opposition to the Second Bank culminated in President Jackson's veto of the Bank's recharter in 1832. The public "war" on the Bank was born in large part from the "undying hostility of the states"[12] and was in reality a fierce political debate over who would control banking. Jackson sided with those in favor of "states' rights" and, once again, a federal banking system was destroyed.

The problems created by a state-governed banking system became critical during the Civil War. As the debates surrounding the Act demonstrate, financial stability was imperative in order to enable the federal government to raise badly needed funds for the Union's war effort and otherwise to support the economy.[13]

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[11] *See also Osborn* v. *Bank of United States*, 22 U.S. (9 Wheat.) 738 (1824). This Court's decisions in *M'Culloch* and *Osborn* spawned intense opposition, particularly in the South and West. *See* BANKING THEORIES, *supra*, at 23-27.

[12] *See* RALPH C.H. CATTERALL, THE SECOND BANK OF THE UNITED STATES 164 (1903). "Nowhere were the centralizing tendencies of the Democratic program perceived more astutely than in the South, which was always vigilant with respect to states' rights." LARRY SCHWEIKART, BANKING IN THE AMERICAN SOUTH FROM THE AGE OF JACKSON TO RECONSTRUCTION 16 (1987).

[13] *See Veazie Bank* v. *Fenno*, 75 U.S. (8 Wall.) 533, 536-39 (1869); *see also* CONG. GLOBE, 38th Cong., 1st Sess. 2132 (1864) ("We are in the very straining point. If we pass this point, we go through. If we fail financially now, we fail altogether.") (remarks of Sen. Chandler); CONG. GLOBE, 38th Cong., 1st Sess. 1257 (1864) ("The loan bill, including the issue of legal-tender notes, the national bank act, and the tax law were recommended by the Secretary of the Treasury as the three measures to be relied upon to carry the nation through the financial difficulties of this

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Congress also recognized that the banking system in the South would need extensive repair after the war. The war had drained finances in the South even more than in the North, leaving many Southern states with no surviving banks at all. Any chance of the South's recovery after the war would necessarily depend on the inflow of capital from the money centers of the North.[14]

To solve these pressing problems, Congress chose to establish a uniform national currency; this in turn required a strong national banking system. As President Lincoln explained, there was "no other mode by which 'the great advantages of a safe and uniform currency' could be achieved so promisingly and unobjectionably as by 'the organization of banking associations under a general act of Congress.'"[15] With many of the most ardent supporters of states' rights absent from Congress as a result of the secession of the

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[13](...continued)
war.") (remarks of Rep. Hooper); *id.* at 1256 ("I frankly confess that I look upon the system of State banks as having outlived its usefulness, as being unequal to the exigencies of the present time, with the demands which this war is making on the resources of the country and on its financial and monetary systems.") (remarks of Rep. Hooper).

[14] *See* CONG. GLOBE, 37th Cong., 3d Sess. 841 (1863) (speaking in favor of the National Currency Act, the precursor to the Act, Senator Sherman asserted: "We know very well that after this war is over . . .; that when the rebellion is subdued, the condition of society in Southern states will be disturbed . . . ."); SCHWEIKART, *supra*, at 309-11. After the war, circulation of bank notes was disproportionately high in the North and disproportionately low in the South. Gische, *supra*, at 62.

[15] HAMMOND, SOVEREIGNTY, *supra*, at 290. In 1887, this Court explained that "[t]he object of the [Act] was to establish a system of national banking institutions, in order to provide a uniform and secure currency for the people, and to facilitate the operations of the treasury of the United States." *Mercantile Nat'l Bank* v. *New York*, 121 U.S. 138, 154 (1887).

Southern states, a national banking system under federal control was now politically feasible.[16]

B. In Enacting the National Bank Act, Congress Recognized and Sought To Neutralize State Hostility to National Banks.

The history of state hostility towards the First and Second Banks of the United States provided Congress with ample experience as to the likely reaction of many states to federally chartered banks. Congress understandably expected states to attempt to enact burdensome and discriminatory legislation against banks chartered under the new federal system and to attempt to impose restrictions on out-of-state banks. As Representative Davis stated:

> But whether right or wrong, I am willing to do anything that may be thought best in favor of strengthening this [national system] and the banks that are to be organized under it in the impending conflict with the State institutions.[17]

This Court has consistently recognized this Congressional concern and interpreted the Act in a manner aimed at limiting the ability of the states to regulate national banks in order to ensure that national banks could compete effectively with state banks and on a national basis. *See, e.g., Tiffany* v. *National Bank*, 85 U.S. (18 Wall.) 409, 412-13 (1874) ("it was intended to give [national banks] at least equal advantages in" competition with state banks); *Dearing*, 91 U.S. at 33-35; *Marquette Nat'l Bank* v. *First of Omaha Serv. Corp.*, 439 U.S. 299, 313-18 (1978).

[16] *See* 1 A HISTORY OF BANKING IN ALL THE LEADING NATIONS 464 (William G. Sumner ed. 1971) (1896) ("It is a great point which must be put to the credit of the civil war that it brought about what was otherwise a political impossibility": a national banking system).

[17] CONG. GLOBE, 38th Cong., 1st Sess. 1400 (1864) (remarks of Rep. Davis). *See also id.* at 1894 ("Of course the new system must begin in rivalry with the State banks, which in many cases will be hostile.") (remarks of Sen. Sumner); *id.* at 1393 ("to carry out that object [to make this a great national system] it will not do to place it in the power of the States, otherwise you place it in the power of any State which may be opposed to the system to cripple and destroy it") (remarks of Rep. Washburn).

To protect the newly formed national banks from potentially destructive state legislation, the Act provided that the regulation of national banks was to be a matter of federal law and enacted a comprehensive — and exclusive — regulatory scheme. One aspect of this scheme was Section 85, in which Congress specified that a national bank was authorized under *federal* law to charge borrowers — wherever located — the highest rate allowed by the national bank's home state, even if that rate was higher than the rate which could be charged by state banks.[18] Moreover, Congress provided that any challenge to a national bank's lending charges could be brought only under federal law. 12 U.S.C. § 86; *Dearing*, 91 U.S. at 32-36.

Initially, Congress considered establishing a uniform usury rate for national banks (and it did so where a state or territory provided no rate). *See Daggs* v. *Phoenix Nat'l Bank*, 177 U.S. 549 (1900). But Congress ultimately rejected that idea, and instead decided to place national banks "on precisely the same footing [as lenders] doing business in the [bank's home] State by its laws."[19] Thus, lending rates

[18] *Tiffany*, 85 U.S. (18 Wall.) at 411-13. In this respect, Section 85 is consistent with other provisions of the Act which apply federal definitions to the terms used in the Act even in provisions incorporating state law. *See* 12 U.S.C. §§ 36 (branching), 92a (trust powers); *First Nat'l Bank* v. *Dickinson*, 396 U.S. 122, 131-34 (1969) (term "branch" in 12 U.S.C. § 36 is defined by federal law).

[19] CONG. GLOBE, 38th Cong., 1st Sess. 2126 (1864) (remarks of Sen. Sherman). Congress rejected an amendment that would have allowed state legislatures discretion to *reduce* the amount of "interest" a national bank could charge below that which a state bank could charge. As

(continued...)

were immune, as a practical matter, from state discrimination because a state could limit a national bank's lending rates only by imposing identical restrictions on *all* local lenders. Section 85 was structured to advance Congress's goal of protecting national banks from "the hazard of unfriendly legislation by the States." *Tiffany*, 85 U.S. (18 Wall.) at 413.

Congress's concern that national banks be protected from "unfriendly legislation" was no doubt increased by the possibility that the Southern states might soon be readmitted to the Union, either by peaceful or military means. At their national convention in August 1864, the Democrats nominated General McClellan for President on a "peace" platform, which demanded restoration of the "Federal Union" by calling for "an ultimate convention of the states" without mention of the divisive issue of slavery. *See* MCPHERSON, *supra*, at 771-72.[20] At the same time, Congress expected that even if "peace" were not achieved in such fashion, the North would eventually prevail in the war and readmit the Southern states to the Union on its terms.[21]

Given that Congress anticipated that the Southern states — long home to the most zealous advocates of "states' rights" and foes of federally chartered banks — would be

[19](...continued)
Representative Pike stated: "[W]ould it not enable the Legislature of a State to kill off the national banks of that State?" *Id.* at 1375 (remarks of Rep. Pike).

[20] There was considerable speculation at the time that McClellan might actually defeat Lincoln in the fall elections. Indeed, for a period of time Lincoln himself expected McClellan to win. *See id.* at 771.

[21] As of June 1864, military or provisional civil governments were in place in occupied Arkansas, occupied Louisiana, occupied North Carolina (coastal region), occupied Tennessee, and occupied Texas (coastal region). *See* ROY G. GLASHAN, AMERICAN GOVERNORS AND GUBERNATORIAL ELECTIONS, 1775-1978, at 17, 113, 230, 291, 298 (1979).

extremely hostile to the new federal banking associations, protection from hostile state legislation was vital to enabling national banks to engage in business in the South.

A key reason for protecting national banks from hostile state legislation was to create a strong national banking system that could operate effectively in interstate commerce. *See Marquette*, 439 U.S. at 314-15 ("Congress intended to facilitate what Representative Hooper termed a 'national banking system.'") (quoting CONG. GLOBE, 38th Cong., 1st Sess. 1451 (1864) (remarks of Rep. Hooper)). Reviewing the provisions and legislative history of the Act, the *Marquette* Court concluded that Congress "recognized the interstate nature of American banking." *Id.* at 315-17 (noting the "developed interstate loan market" in 1864).[22]

In fact, the Civil War Congress envisioned that national banks would ultimately *replace* state banks, and in March 1865 (less than one year after the Act was passed) it attempted to tax state banks "out of existence" with a ten percent confiscatory tax on state bank notes. *Tiffany*, 85 U.S. (18 Wall.) at 413; *see* Internal Revenue Act of 1865, ch. 78, § 6, 13 Stat. 469, 484.[23] Although this attempt

[22] *See also* CONG. GLOBE, 38th Cong., 1st Sess. 2021 (1864) ("[National] banks will, of course, have very extensive loan transactions all over the country. They are organized for that purpose.") (remarks of Sen. Johnson).

[23] Congressional debates show that Congress's purpose in enacting the ten percent tax was to destroy the state banks. *See* CONG. GLOBE, 38th Cong., 2d Sess. 1139 (1865) ("The national banks were intended to supersede the State banks. Both cannot exist together . . . .") (remarks of Sen. Sherman); *id.* at 1195 ("Many members who were in favor of taxing State banks out of existence could not agree upon the terms. Finally, however, they did agree upon this fifth section. That will, I think, effectually do the work . . . .") (remarks of Sen. Sherman).

ultimately failed,[24] the unmistakably clear intent of the Civil War Congress which enacted the Act was to centralize power over the national economy by means of a strong national banking system and to immunize that banking system from state control. The Act was framed to achieve those ends.

II. By Providing That a National Bank Could Charge "Interest" at the Highest Rate Allowed in Its Home State, Congress Advanced Its Goal of Creating a Strong National Banking System.

Section 85 is a provision specifically designed to carry out Congress's goal of creating a strong national banking system.[25] By its terms, a national bank could charge the highest "interest" allowed any lender by the laws of the state in which the bank was located. By using the broad term "interest" — which applied to a variety of lending charges — Congress substantially advanced its goal of establishing a strong national banking system subject to uniform, non-discriminatory lending restrictions and able to compete effectively in interstate commerce.

A. The Plain Meaning of Interest in 1864 Included All Lending Charges.

To understand the commonly accepted definition of interest in 1864, it is necessary to appreciate the development of that term's usage over time. The concept of interest grew in juxtaposition to the concept of usury, and in both 1864 and today, the two words have significantly different meanings.

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[24] Despite the confiscatory tax on their notes, state banks continued to function as banks of deposit. *See* HAMMOND, SOVEREIGNTY, *supra*, at 347.

[25] *See* CONG. GLOBE, 38th Cong., 1st Sess. 2126 (1864) (remarks of Sen. Sherman); *see supra* note 19.

Under canon law, the practice of usury, defined as the price paid for the *use* of money, was forbidden. SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 73 (3d ed. 1991); (A 18-19 n.7 (quoting 7 OXFORD ENGLISH DICTIONARY 1099-1100 (2d ed. 1989))). Understandably, exceptions arose to this absolute prohibition. Those exceptions became known as "*interesse*" in Roman Law, which was derived from the "Latin verb *intereo* meaning to be lost." HOMER & SYLLA, *supra*, at 73.

The "*interesse*" exceptions to usury were justified as "compensation due to a creditor because of a loss which he had incurred through lending," *id.*, *i.e.*, a charge not for the *use* of money but for the *loss of use* of money. Such losses occurred if either the money could have been used profitably had it not been loaned or the debtor did not repay the loan at the agreed date, in which case a "penalty for delay might be charged." *Id.* at 73-74; *accord Library of Congress* v. *Shaw*, 478 U.S. 310, 315 n.2 (1986) (The "institution of interest originated under Roman law as *a penalty due from a debtor who delayed or defaulted in repayment of a loan*.") (emphasis supplied); (A 18-19 n.7).

By the time the Act was passed, "interest was divided into two great and well defined classes, the first being that of contractual interest, and the second interest allowed as damages" for the detention of a debt. SIDNEY PERLEY, PRINCIPLES OF THE LAW OF INTEREST 5 (Boston, George B. Reed 1893); *accord* EDWARD CARROLL, JR., PRINCIPLES AND PRACTICE OF FINANCE 35 (New York, G.P. Putnam's Sons 1895) ("[i]nterest is charged not only on loans but on debts overdue"). Dictionaries of the era confirm this ordinary usage. *See, e.g.*, 2 T. CUNNINGHAM, A NEW AND COMPLETE LAW DICTIONARY (London 1765) (defining "interest of money" and noting that "[i]nterest is recovered by way of damages, where damages are recovered *ratione detentionis debiti*"); 1 JOHN BOUVIER, A LAW DICTIONARY 733 (Philadelphia, J.B Lippincott & Co., 14th rev. ed. 1877) (defining "interest" as "compensation which is paid by the

borrower of money to the lender for its use, and, generally, by a debtor to his creditor in recompense for his detention of the debt"); (A 18-19 & n.7 (citing three other similar dictionary definitions)).

Similarly, nineteenth century judicial opinions routinely held that "interest" includes "compensation . . . for the use . . . of money, or as damages for its detention." *Brown* v. *Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1872). Indeed, this Court noted in *Shoemaker* v. *United States*, 147 U.S. 282, 321 (1893), "Interest" includes "damages, by reason of the failure of the debtor to pay the principal when due." *Accord United States* v. *North Carolina*, 136 U.S. 211, 216 (1890) ("Interest . . . is allowed by the courts as damages for the detention of money . . ., or of compensation, to which the [lender] is entitled."); *Redfield* v. *Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) ("Interest is given on money demands as damages for delay in payment, being just compensation to the plaintiff for a default on the part of his debtor.").[26] Thus, delinquency charges — *i.e.*, additional charges imposed because of late payment — fall squarely within the classic

[26] Many state-court decisions also employed this classic definition in their analyses. *See, e.g.*, *Barnard* v. *Wyllis*, 39 Mass. 291, 294 (1839) (interest "may be given as damages for the detention of a debt after the time when due by the terms of the agreement"); *Griffin* v. *His Creditors*, 6 Rob. (Vir.) 216, 220 (1843) (Virginia statute "declares, that 'the damages due for delay in the performance of an obligation to pay money, are called interest'"); *Hubbard* v. *Callahan*, 42 Conn. 524, 528-30 (1875) ("interest was allowed, in the nature of damages, for the detention of money"); *State* v. *Lott*, 69 Ala. 147, 154-55 (1883) ("Interest, in this State, has long been regarded not as a mere incident of debt . . . for the payment of money, but as compensation for the use, or for the detention of money."); *Sorensen* v. *Central Lumber Co.*, 98 Ill. App. 581, 582 (1901) ("Interest is defined to be, '[t]he compensation which is paid by the borrower of the money to the lender, for its use, and generally, by a debtor to his creditor, in recompense for his detention of the debt.'").

definition of interest, and many nineteenth century cases apply the laws regulating "interest" to such charges.[27]

B. The Narrower Definition of Some Usury Statutes Is Irrelevant in Interpreting Section 85.

In contrast to the traditional definition of interest, the term "usury" referred to "the taking, under contract," of compensation in excess of statutory limits. JAMES A. WEBB, A TREATISE ON THE LAW OF USURY § 1, at 1-2 (St. Louis, The F.H. Thomas Law Book Co. 1899); *see also* 2 JOHN BOUVIER, A LAW DICTIONARY 616 (Philadelphia, T. & J.W. Johnson, 3d ed. 1848) (distinguishing between the terms "usury" and "interest"); A.T. FOLSOM, A SUMMARY OF USURY LAWS AND DECISIONS 1 (1927). There is an obvious relationship between the concepts of usury and interest; if the interest charges are within statutory limits, they are *not* usurious. Nonetheless, in view of the different linguistic and conceptual origins of the two terms, the decisions by some legislative bodies and courts to exclude late charges from the concept of usury does not suggest that late charges are not interest.

[27] *See Greenwood Trust Co.*, 971 F.2d at 825 ("[F]ederal case law has long suggested that, in ordinary usage, interest may encompass late fees and kindred charges."). State courts were in accord. *See, e.g.*, *Wernwag* v. *Mothershead*, 3 Blackf. 401, 402 (Ind. 1834) (five dollars per week late payment charge was permissible "interest at the rate specified in the note from the time it became due"); *Wilkinson (Wilkerson)* v. *Daniels*, 1 Greene 179, 188 (Iowa 1848) (contract providing for three percent late payment charge — raising the loans interest rate from twelve to fifteen percent — "is a contract to pay fifteen per cent. *interest* per annum on a contingency") (emphasis supplied); *Daggett* v. *Pratt*, 15 Mass. 177, 177 (1818) (promissory notes specified "interest at three per cent. per annum, if paid at their maturity; if not, six per cent. interest to be paid"; court held that the six percent charge, which included a three percent late charge, was a proper "interest" charge); *Craig* v. *Pleiss*, 26 Pa. 271, 273 (1856) (flat $25 charge for late payment was "interest" subject to statute limiting permissible rates).

At the outset, the distinction between "usury" and "interest" can be observed from the roots of those terms. The Latin root of usury — *usura* — "means the 'use' of anything, in this case the use of borrowed capital; hence usury was the price paid for the use of money." HOMER & SYLLA, *supra*, at 73. In contrast, as discussed above, "[t]he Latin verb *intereo* means 'to be lost'; [thus] [i]nterest was not profit but loss." *Id.*; (*see* A 18-19 n.7 (discussing similar linguistic analysis in 7 OXFORD ENGLISH DICTIONARY 1099-1100 (2d ed. 1989))).

In Anglo-American jurisprudence, usury has been entirely a matter of statutory law. At common law, there were no limits on charges for the use of money agreed to by the parties. *See, e.g.*, *Sodi, Inc.* v. *Salitan*, 68 So. 2d 882, 885 (Fla. 1953); WEBB, *supra*, § 5, at 3. Many usury statutes, reflecting the origin of the concept of usury, restricted only charges imposed for the use of money and did *not* limit damages for its detention. *See* ROBERT B. COMYN, A TREATISE ON THE LAW OF USURY 72 (1834), *reprinted in* 5 THE LAW LIBRARY (Philadelphia, J.S. Littell, J. Purdon ed. 1834); FRANCIS PLOWDEN, TREATISE UPON THE LAW OF USURY AND ANNUITIES 181 (London 1797).

Moreover, in many cases the decision to exclude late charges from the definition of usury reflected the disfavored status of usury statutes. By the mid-nineteenth century, the moral and religious conceptions underlying usury laws had been largely discredited: many believed that usury statutes were unjust and hindered economic development. *See Lloyd* v. *Scott*, 29 U.S. 205, 224 (1830) ("[t]he act of usury has long since lost that deep moral stain, which was formerly attached to it"); MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW: 1780-1860, at 237-45 (1977). State courts reflected this mood by limiting the scope of these

statutes.[28] As a part of this effort, charges or fees which did not directly relate to the use of money were excluded from the calculation of usury.

In light of the distinction between interest and usury, the usury cases on which Petitioner relies, (*see* Brief for Petitioner at 33-39), do not support her contention that, at common law, late fees were not "interest." Instead, these cases merely reflect the fact that many usury statutes restricted only charges imposed on the use of money and were interpreted narrowly. They had nothing to do with the meaning of the term "interest" under the common law or in general usage.[29]

[28] *See id.* at 244-45 ("it was widely possible by the time of the Civil War to arrange usurious transactions in such a way as to entirely avoid running afoul of the usury laws"); JOHN A. JAMES, MONEY AND CAPITAL MARKETS IN POSTBELLUM AMERICA 82-88 (1978) ("Usury laws were a government-imposed constraint . . ., but we have seen that it was not really a binding one.").

[29] Moreover, despite the restrictive view of some usury statutes, many states included post-maturity charges in determining whether a loan was usurious. *See, e.g.*, *Bang* v. *Windmill Co.*, 96 Tenn. 361, 365 (1896) (note providing for post-maturity charges greater than usury limit held usurious); *Griffin*, 6 Rob. (Vir.) at 220-21 (a provision calling for payment "for the inexecution of an obligation to pay money" is unenforceable because "[a]ny contract or agreement, into whatever shape it may be thrown, which stipulates for more than ten per cent damages, or interest, for the delay to pay money, is illegal"); *Fry* v. *Coleman*, 1 Grant's Cases 445, 447 (Pa. 1857) (agreement to pay flat $100 fee if two notes were not paid within 10 days after maturity is usurious); *see generally* Annotation, *Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious*, 82 A.L.R. 1213, 1218-23 (1933) [hereinafter *Interest After Maturity*] (collecting cases). Some states adopted the test of whether such a charge "was intended as an evasion of the [usury] statute" or "was in fact a device to procure more than lawful interest," while others simply prohibited the charge of greater than the legal maximum after maturity. WEBB, *supra*, § 119, at 135-36, § 121, at 137; *see Interest After Maturity*, *supra*, at 1218-23.

C. Nineteenth Century Banking Practices Confirm That "Interest" Included All Lending Charges.

The banking practices of the nineteenth century confirm that the commonly accepted definition of "interest" was broad. At that time, banks provided credit on a variety of terms and were often compensated in ways other than periodic, time-based percentage rates. Congress understood that banks engaged in these various transactions, and mentioned some explicitly in Section 85. This directly refutes the notion that Congress intended the term "interest" to be as narrow as Petitioner contends.

Some of the more popular banking practices in the mid-nineteenth century included discounts,[30] bills of exchange,[31] loan commissions[32] and compensating balance

[30] A discount is a transaction whereby a bank advances a customer a sum of money less the discount charged; at maturity, the customer must pay off the entire sum. JAMES, *supra*, at 54.

[31] Bills of exchange were 19th century instruments used both to lend money and transfer that money from one location to another. The transaction was structured as "an order from one person to another living in a different place directing him or her to pay a given amount of money to a third person." *Id.* at 51. The "exchanged" money was often lent by a bank at either a discount or in exchange for periodic loan payments. BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR 700 (1957). If the exchange involved two locations where the value of the money was different (if, for example, there was a surplus or shortage of dollars in one of the locations), the bank would charge an "exchange fee" for at least the amount of that difference. *See id.*; JAMES, *supra*, at 53; *infra* pp. 21-22.

[32] Banks often found ways to receive commissions on their loans in addition to a percentage charge. For instance, banks were able to charge commissions for appraising the value of collateral, *see* Davis R. Dewey, *State Banking Before the Civil War*, *reprinted in* NATIONAL MONETARY COMMISSION REPORT 162-63, S. DOC. No. 581, 61st Cong., 2d Sess. (1910), and for buying notes from brokers, ALBERT O. GREEF, THE

(continued...)

requirements.[33] Each of these transactions allowed banks to impose lending charges in addition to, or instead of, periodic time-based payments.

The practice of discounts was particularly widespread in the nineteenth century.[34] In fact, discounts and bills of exchange were so common that Congress explicitly provided in Section 85 that banks could receive "interest" in these transactions.[35] It is thus impossible to conclude that Congress intended that "interest" would include only time-based periodic percentage charges.

Indeed, Congress made its intention to cover all loan charges under Section 85 even clearer in its treatment of exchange fees: In the mid-nineteenth century, banks often exacted profits from bills of exchange by charging, in addition to a discount or percentage-based interest rate,

[32](...continued)
COMMERCIAL PAPER HOUSE IN THE UNITED STATES 14-15 (1938). A considerable body of law developed as to whether broker fees and other similar commissions could be considered usurious. *See* Annotation, *Usury: Expenses or Charges in Forms of Commissions to Agents, Brokers, or Like Intermediaries Incident to Loan of Money*, 52 A.L.R. 2d 703 (1957) (collecting cases from 19th and 20th centuries).

[33] Banks often required borrowers to keep a portion of funds lent — called a "compensating balance" — in the bank, thus allowing the bank to receive a higher effective rate of interest on the money that actually left the bank. JAMES, *supra*, at 84; GREEF, *supra*, at 15 n.35 (*quoting* CONDY RAGUET, A TREATISE ON CURRENCY AND BANKING 105 (1840)).

[34] *See* JAMES, *supra*, at 55-56; J.S. GIBBONS, THE BANKS OF NEW YORK, THEIR DEALERS, THE CLEARING HOUSE, AND THE PANIC OF 1857, at 236-37 (1859) (1857 bank statement shows "bills discounted" as almost 60% of assets and over 18 times the amount of "loans").

[35] "[E]very association may take, receive, reserve, and charge on any loan or *discount* made, or upon any note, *bill of exchange*, or other evidences of debt, interest at the rate allowed by the laws of the state . . . where the bank is located . . . ." (Emphasis added.)

exchange fees that were greater than the difference in currency value between the two locations involved in the transaction.[36] The practice had received the attention of numerous state governments and banking regulators prior to enactment of the Act. Dewey, *supra*, at 168-76. Section 85 specifically addressed this problem: an exchange fee "at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest." Congress thus specifically recognized that exchange fees in excess of the "current rate of exchange for sight drafts" (*i.e.*, the market rate) were within the definition of "interest" in Section 85.[37]

These provisions of Section 85 confirm that Congress intended to use the term "interest" in accordance with its generally accepted meaning in 1864 and to apply it to a wide variety of lending charges other than periodic time-based percentage payments. There is no principled reason for excluding late fees from that usage.

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[36] For example, if the current rate of exchange between Connecticut and New York was ¼%, a bank might charge the customer as high as 3%. *See* Dewey, *supra*, at 167-68.

[37] In debating the National Currency Act, which contained a similar provision, Senator Sherman contended that "bankers can make a reasonable profit under this bill I have no doubt" because, in part, "[t]hey have the benefit of exchange; not the rates of exchange formerly paid, but that incidental exchange which every bank draws in charges in drawing a draft, probably a quarter or a half of one percent." CONG. GLOBE, 37th Cong., 3d Sess. 875 (1863) (remarks of Sen. Sherman). This clear statement of Congressional intent was later embodied in Section 85: although the small exchange fees reflecting the bank's cost of exchanging currency would be exempted from Section 85, larger fees imposed in connection with bills of exchange *would be* included in the definition of "interest."

D. The Broad, Historical Definition of Interest Is Consistent with Congress's Objective in Enacting the National Bank Act.

The broad, historical definition of interest, as including all lending charges, is consistent with, and indeed compelled by, Congress's objectives in enacting the Act. Absent such a provision governing lending, interstate commerce could be seriously impeded because each state could impose its own separate limits on late fees and other charges on every national bank, thus greatly burdening the process of interstate lending, and national banks would lack the flexibility to deal with a wide variety of forms of credit extensions and changing financial and economic circumstances.

III. Consistent Construction of the National Bank Act

In the years immediately after passage of the Act, the courts interpreted its scope and effect broadly in order to assure that, as Congress intended, the newly established federal instrumentalities were protected from state interference. As this Court explained only ten years after passage of the Act, "National banks have been National favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government." *Tiffany* v. *National Bank*, 85 U.S. (18 Wall.) 409, 413 (1874). In order to effectuate that purpose, the *Tiffany* decision bestowed upon national banks the status of "most favored lender," a doctrine subsequently adopted by the OCC. *See Marquette Nat'l Bank* v. *First of Omaha Serv. Corp.*, 439 U.S. 299, 314 n.26 (1978).

The following year, this Court again confirmed that Sections 85 and 86 should "be liberally construed to effect the object which Congress had in view in enacting [them]." *Farmers' & Mechanics' Nat'l Bank* v. *Dearing*, 91 U.S. 29, 35 (1875). The Court concluded that these sections "cover the entire subject" of national bank lending and that "the

power to supplement [them] by State legislation is conferred neither expressly nor by implication." *Id.* at 32, 35. In words of equal force here, the Court in *Dearing* also reaffirmed the goal of uniformity under the Act by rejecting the defendant's proposed interpretation of Sections 85 and 86, which would have led to divergent penalties for violating interest rate ceilings in different states:

> A purpose to produce or permit such a state of things ought not to be imputed to Congress, unless the circumstances are so cogent as to render that result inevitable.

Id. at 33.

This approach to construing Section 85 continued in subsequent decisions. In *Citizens National Bank* v. *Donnell*, 195 U.S. 369 (1904), this Court applied Section 85 to cover late charges (specifically, monthly charges on an overdrawn account), thus recognizing the broad definition of "interest" intended by Congress. Other federal and state court decisions — often without even considering the possibility that interest could be more narrowly defined — have consistently so applied Section 85 for over a hundred years. Most relevant here, they have consistently held that Section 85 covers all lending charges received by a national bank whether or not there was a time element.[38]

[38] These charges have included bonuses and commissions, *Cronkleton* v. *Hall*, 66 F.2d 384 (8th Cir.), *cert. denied*, 290 U.S. 685 (1933); *Baker* v. *Lynchburg Nat'l Bank*, 91 S.E. 157 (Va. 1917); credit card cash advance charges, *Fisher* v. *First Nat'l Bank*, 548 F.2d 255 (8th Cir. 1977); charges for mortgage taxes and recording fees, *Panos* v. *Smith*, 116 F.2d 445 (6th Cir. 1940); *Schumacher* v. *Lawrence*, 108 F.2d 576 (6th Cir. 1940); compensating balance requirements, *American Timber & Trading Co.* v. *First Nat'l Bank*, 690 F.2d 781 (9th Cir. 1982); *McAdoo* v. *Union Nat'l Bank*, 535 F.2d 1050 (8th Cir. 1976); and brokerage fees, *In re Gerber's Estate*, 9 A.2d 438 (Pa. 1939).

Construing Section 85 in recent years, this Court has reaffirmed that the primary purpose of the Act was to foster interstate lending free of state law interference. Thus, in *Marquette*, this Court unanimously held that Section 85 preempts the application of any state laws limiting credit card lending rates to national banks' interstate credit card accounts because it is "implausible to conclude . . . that Congress meant . . . to exempt interstate loans from the reach of [Section 85]." 439 U.S. at 318. Indeed, as Senator Johnson stated during debates on the Act:

> These [national] banks will, of course, have very extensive loan transactions all over the country. They are organized for that purpose, and they will be sure to carry it out to the whole extent of the power, if they can do it with anything like safety to themselves.[39]

This broad concept of interest for purposes of Section 85 has been repeatedly accepted by the OCC, which has exclusive supervisory responsibility for national banks. *See* 12 U.S.C. §§ 21 *et seq.* For years, the OCC has interpreted Section 85 broadly to include all charges, in furtherance of Congress's clear purpose to protect national bank lending from state regulation.[40]

[39] CONG. GLOBE, 38th Cong., 1st Sess. 2021 (1864) (remarks of Sen. Johnson).

[40] *See, e.g.*, 61 Fed. Reg. 4849, 4869 (1996) (to be effective on April 1, 1996 and codified at 12 C.F.R. § 7.4001); Letter from Robert B. Serino, OCC Deputy Chief Counsel (Policy) 2 (Aug. 11, 1988), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,064 (OCC Interpretive Letter No. 452); Letter from William P. Bowden, Jr., OCC Chief Counsel, 1992 WL 136390 (OCC) (Feb. 4, 1992); Letter from Richard V. Fitzgerald, Director, OCC Legal Advisory Servs. Div. 3-4 (Nov. 24, 1980).

Conclusion

For the reasons stated, the judgment of the Supreme Court of California should be affirmed.

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(18)

No. 95-860

In The

Supreme Court of the United States

October Term, 1995

BARBARA SMILEY,

Petitioner,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Respondent.

On Writ Of Certiorari To The California Supreme Court

BRIEF OF GREENWOOD TRUST COMPANY AND THE CHASE MANHATTAN BANK (USA) AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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INTEREST OF AMICI CURIAE

Greenwood Trust Company ("Greenwood") and The Chase Manhattan Bank (USA) ("Chase") submit this brief as *amici curiae* in support of the position of Respondent Citibank (South Dakota), N.A. ("Citibank") that the judgment of the California Supreme Court should be affirmed.[1]

Greenwood and Chase are federally-insured state banks that each issue tens of millions of credit cards to customers in all fifty states. As federally-insured state banks, Greenwood and Chase derive their federal lending authority from Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), 12 U.S.C. § 1831d, which has been codified as Section 27 of the Federal Deposit Insurance Act. Congress incorporated into Section 521 of DIDA the same language long used in Section 85 of the National Bank Act for the specific purpose of conferring upon federally-insured state banks the same lending authority enjoyed by national banks under Section 85. *See Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 826-827 (1st Cir. 1992), *cert. denied*, 113 S.Ct. 974 (1993). Since Section 521 of DIDA has uniformly been construed *in pari materia* with Section 85 of the National Bank Act, this Court's construction of Section 85 in this case is vitally important to Greenwood and Chase, as well as all other federally-insured state banks.

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[1] Pursuant to Court Rule 37.3, this brief is filed with the consent of the parties. Letters of consent have been filed with the Clerk's Office.

Moreover, both Greenwood and Chase are involved in a number of class action lawsuits around the country that challenge their assessment of credit card late charges, including several cases now pending in this Court. *Greenwood Trust Co. v. Hunter*, No. 95-963 (petition for certiorari filed Dec. 18, 1995); *Stoorman v. Greenwood Trust Co.*, No. 95-1500 (petition for certiorari filed March 18, 1996); *Harris v. Chase Manhattan Bank*, No. 95-951 (petition for certiorari filed Dec. 18, 1995). Also, the Court's construction of Section 85 will have a direct effect upon Chase, since it was a national bank prior to June, 1990 and the aforementioned cases brought against it seek relief for conduct that occurred during the time period when it was a national bank.

As pointed out in Citibank's brief, national banks have long exported credit card late charges permitted by the laws of their home States in reliance upon the consistent position of the Comptroller of the Currency ("OCC") that late charges are "interest" for purposes of Section 85. Likewise, Greenwood, Chase, and other federally-insured state banks have exported late charges permitted by the laws of their home States in reliance upon the view of the Federal Deposit Insurance Corporation ("FDIC") that late charges are "interest" under Section 521 of DIDA. FDIC Op. No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992). Therefore, adoption of petitioner's argument that late charges should not be considered "interest" would wreak havoc not only on national banks, but on state banks as well and would expose the entire banking industry to potentially enormous damage claims.

SUMMARY OF ARGUMENT

As demonstrated in Citibank's brief, the California Supreme Court's decision holding that late charges are "interest" under Section 85 comports with the language and purposes of the statute, the established meaning of "interest" at the time the National Bank Act was enacted, as well as numerous judicial precedents and OCC opinions construing Section 85. The arguments made by Citibank on these issues are supported by Greenwood and Chase and will not be reiterated herein.

Greenwood and Chase are federally-insured state banks governed by Section 521 of DIDA, which was expressly modeled on Section 85. Courts and the FDIC have held that Section 521 should be construed in the same manner as Section 85, and just as late charges are "interest" under Section 85, so too are they "interest" under Section 521. Moreover, as shown below, the amendments to Section 511 and Section 522 of DIDA demonstrate that Congress understood the term "interest" to encompass all loan related charges. Petitioner and her amici have relied on the legislative history of Section 501 of DIDA, but the California Supreme Court, First Circuit Court of Appeals and FDIC have all properly concluded that this legislative history has absolutely no relevance to the meaning of "interest" in either Section 85 or Section 521. *Smiley v. Citibank*, 11 Cal. 4th at 159 and n. 14; *Greenwood Trust Co. v. Massachusetts*, 971 F.2d at 830 n. 10; FDIC Op. No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992).

The California Supreme Court correctly interpreted the meaning of "interest" in Section 85, and therefore its judgment should be affirmed.

ARGUMENT

I. Courts and Federal Banking Agencies Have Held that Late Charges Are "Interest" Under Sections 521-523 of DIDA, Which Were Modeled on Section 85

As acknowledged in petitioner's brief (p. 44), Section 85 served as the model for Section 521 of DIDA when the latter statute was enacted in 1980. Section 521, like its progenitor, provides that federally-insured state banks may "take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located *or at the rate allowed by the laws of the State, territory, or district where the bank is located*, whichever may be greater." 12 U.S.C. § 1831d(a) (emphasis added). Moreover, the remedy provisions in Section 521(b) of DIDA are virtually identical to those contained in 12 U.S.C. § 86.

Also, at the same time that Congress enacted Section 521 of DIDA, it enacted identical provisions governing federally insured savings and loan institutions (Section 522 of DIDA, 94 Stat. 165, 12 U.S.C. § 1463(g)) and federally insured credit unions (Section 523 of DIDA, 94 Stat. 166, 12 U.S.C. § 1785(g)). Like Section 521, these provisions

incorporated the same language previously used in Section 85.[2]

The purpose of Sections 521-523 of DIDA was to place federally-insured state banks, savings and loans, and credit unions in a position of competitive equality with national banks, which historically had been statutorily favored with respect to usury authority. Indeed, the preamble of Section 521 expressly states that it was enacted "[i]n order to prevent discrimination against State-chartered insured depository institutions . . . " 12 U.S.C. § 1831d(a). After setting forth a comprehensive review of the legislative history of Section 521, the First Circuit properly concluded in *Greenwood Trust Co. v. Massachusetts* that "Congress tried to level the playing field between federally chartered and state-chartered banks when it enacted DIDA," and "the language borrowed from Bank Act § 85 and incorporated into DIDA § 521 achieves parity between national banks and their state-chartered counterparts . . . " 971 F.2d at 826, 827.

Given the incorporation of the Section 85 language into Sections 521-523 of DIDA and the clearly expressed intent of Congress to bestow upon all federally-insured depository institutions the same federal usury authority

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[2] As correctly stated by the California Supreme Court in the decision below, the borrowed language from Section 85 acts "as a choice-of-law provision, fixing the law of the national bank's home state relative to interest rates as the rule governing all loans, even interstate loans, notwithstanding the law of any other state. Section 85 thereby entrusts the question of the lawfulness of a national bank's interest rates to its home state and to its home state alone." 11 Cal. 4th at 149.

previously enjoyed solely by national banks, courts uniformly have held that Sections 521-523 should be construed *in pari materia* with Section 85. *See, e.g., Greenwood Trust Co. v. Massachusetts*, 971 F.2d at 826-828; *Gavey Properties/762 v. First Financial Savings and Loan Ass'n*, 845 F.2d 519, 521 (5th Cir. 1988); *Vanderweyst v. First State Bank of Benson*, 425 N.W.2d 803, 805-807 (Minn.), *cert. denied*, 488 U.S. 943 (1988); *Stoorman v. Greenwood Trust Co.*, 908 P.2d 133, 135 (Colo. 1995), *petition for cert. pending*, No. 95-1500 (filed March 18, 1996); *Harris v. Chase Manhattan Bank, N.A.*, 30 Cal. App.4th 130, 35 Cal. Rptr.2d 733, *review granted*, 38 Cal. Rptr.2d 346, 889 P.2d 540, *review dismissed*, 46 Cal. Rptr.2d 748, 905 P.2d 417 (Cal. 1995), *petition for cert. pending*, No. 95-951 (filed Dec. 18, 1995).

Likewise, the FDIC has concluded ever since the enactment of Section 521 that it should be interpreted in exactly the same manner as Section 85. FDIC Op. No. 81-3, [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,006 (Feb. 2, 1981); FDIC Op. No. 81-7, [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,008 (March 17, 1981); FDIC Op. No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992); FDIC Op. No. 93-27, [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,635 (July 12, 1993).

In *Greenwood Trust Co. v. Massachusetts*, the First Circuit stated that federal appellate courts applying Section 85 "have had little trouble in construing the term 'interest' to encompass a variety of lender-imposed fees and financial requirements which are independent of a numerical percentage rate . . . " 971 F.2d at 829. Since Section 521 is the "lineal descendent" of Section 85, *id.* at 830 n. 10, the court concluded that the preemptive scope

of Section 521, like that of Section 85, extends "well beyond periodic percentage rates." *Id.* at 830.

The First Circuit correctly recognized in *Greenwood Trust* that a late charge fits comfortably within the definition of "interest" set forth by this Court in *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1872): "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." The First Circuit explained that "[s]uggesting that an additional fee attached to a delinquent, defaulted account is related to the creditor's cost of lending that money does no violence to language, to precedent, or, indeed, to logic." 971 F.2d at 825.[3] The Colorado Supreme Court also has held that late charges are "interest" under Section 521 of DIDA, as has the California Court of Appeal. *Stoorman v. Greenwood Trust, supra*, 908 P.2d 133; *Harris v. Chase Manhattan Bank, supra*, 30 Cal.App.4th 130. *Cf. Hunter v. Greenwood Trust Co.*, 143 N.J. 97, 668 A.2d 1067 (1995), *petition for cert. pending*, No. 95-963 (filed Dec. 18, 1995) (holding that Section 521 does not encompass late charges).

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[3] The First Circuit unanimously reversed a trial court decision from the Fall of 1991 which had held that only periodic interest rates are "interest" under Section 521. *Greenwood Trust Co. v. Massachusetts*, 776 F.Supp. 21 (D. Mass. 1991). However, during the 10 months that elapsed between that unprecedented district court decision and the subsequent reversal by the First Circuit, the law firms for petitioner in this case filed scores of class actions against state and national banks around the country challenging their credit card late charges under various states' laws.

Citibank's brief shows that the OCC repeatedly has opined that late charges are "interest" for purposes of Section 85, and the OCC's views are entitled to deference. *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 115 S.Ct. 810, 813-814 (1995). The same conclusion has been reached by all of the other federal banking agencies with respect to the meaning of "interest" in Sections 521-523 of DIDA.

The FDIC, which regulates federally-insured state banks and has interpretive authority under the Federal Deposit Insurance Act (Section 27 of the Act codifies Section 521 of DIDA), has specifically concluded that credit card late charges are "interest" under Section 521. FDIC Op. No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992). Also, it filed briefs as *amicus curiae* in the First Circuit and Supreme Courts of Colorado, New Jersey, and Pennsylvania asserting that late charges are embraced within the ambit of Section 521.

The Office of Thrift Supervision ("OTS"), which regulates federally-insured savings institutions, has opined that credit card late charges are "interest" under Section 522 of DIDA, 12 U.S.C. § 1463(g). Letter of Karen Solomon, OTS Deputy Chief Counsel, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶82,852 (Sept. 29, 1994). The predecessor of the OTS, the Federal Home Loan Bank Board, reached the same conclusion in 1986. Letter of Harry W. Quillian, FHLBB Acting General Counsel, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶82,852 at p. 62,403 (June 27, 1986). *See also* 12 C.F.R. § 571.22 (1995) (under Section 522 of DIDA, savings associations enjoy "competitive equality with national

banks," including most favored lender status). The National Credit Union Administration, which regulates credit unions, opined that credit card late charges are "interest" under Section 523 of DIDA, 12 U.S.C. § 1785(g). Letter of Richard S. Schulman, Acting Assoc. Gen. Counsel, NCUA, 62 Banking Rep. (BNA) 766 (April 11, 1994). *See also* 46 Fed. Reg. 24,153 (1981) (under Section 523 of DIDA, credit unions enjoy most favored lender status).

Federally-insured depository institutions justifiably look to the opinions and interpretations of the federal banking statutes by the federal banking agencies that govern them. Billions of dollars in loan transactions have been conducted annually in reliance upon those banking agency interpretations, and therefore it is especially important that deference be accorded to them. *See, e.g., Zenith Radio Corp. v. United States*, 437 U.S. 443, 457-458 (1978) ("In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.' "). Substantial deference is particularly appropriate since the same statutory interpretation has been reached by five different agencies. *See Clarkson Constr. Co. v. OSHA*, 531 F.2d 451, 457 (10th Cir. 1976) (when "two [or more] administrative bodies having expertise arrive at similar interpretations, a court should be slow to impose its own interpretation").

II. Post-DIDA Legislation Supports the Conclusion That Late Charges Are "Interest"

A. Section 511 of DIDA

Petitioner's brief (p. 41 n.20) points to a temporary amendment of Section 85 and the Federal Deposit Insurance Act in 1974 that allowed national banks and other lenders to charge interest on certain business and agricultural loans at a rate of 5% above the federal discount rate where the bank was located. Pub.L. No. 93-501, §§ 201-206, 88 Stat. 1557, 1558-60 (1974). This statutory provision served as the antecedent for Section 511 of DIDA, a now-sunsetted provision that related to business or agricultural loans of $25,000 or more and was codified as 12 U.S.C. § 86a. Pub.L. No. 96-221, § 511, 94 Stat. 132, 164 (1980).

Petitioner's brief neglects to mention that only six months after DIDA's enactment, Congress amended Section 511 by adding a provision stating that "*the term 'interest' includes any compensation, however denominated, for a loan.*" Pub.L. No. 96-399, § 324(b)(2), 94 Stat. 1614, 1648 (1980) (emphasis added). Senator Proxmire, the sponsor of the legislation and Chairman of the Senate Banking Committee, emphasized that it was simply "a technical clarifying amendment making no substantive changes in the usury preemption provisions." 126 Cong. Rec. S16,112 (1980). This expansive definition of "interest" in Section 86a clearly encompasses late charges.

B. Section 522 of DIDA

As discussed above, Congress incorporated the language of Section 85 into Sections 521-523 of DIDA in 1980. Congress re-codified Section 522 in 1989 as part of the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA"). Pub.L. No. 101-73, § 301, 103 Stat. 183, 282 (1989). The House Report on FIRREA made it plain that the preemptive scope of Sections 521-523 of DIDA is *not* confined to percentage-based interest rates, but includes other fees and charges as well:

> [The rate authorized by Section 522 of DIDA] may be employed notwithstanding any State constitution or statute concerning *loan related charges*, which is thus preempted. *The effect of this section is to preserve the current preemption of state usury laws.* (emphasis added)

H.R. Rep. No. 54 at 343, 101st Cong., 1st Sess., pt. 1 (1989). Since Section 522 was modeled on Section 85, it is clear that Congress reads the term "interest" in both statutes broadly to encompass all "loan related charges."

Moreover, it bears emphasis that Congress has amended Section 521 twice in the past nine years. Pub.L. No. 100-86, § 101(g)(2), 101 Stat. 552, 563 (1987); Pub.L. No. 101-73, § 201(a)(1), 103 Stat. 183, 187 (1989). During this time, Congress undoubtedly was well aware of the widespread practice of exporting late charges and the many judicial and administrative agency opinions holding that the term "interest" in Sections 521-523 of DIDA and Section 85 of the National Bank Act embraces flat late charges and other charges. *See Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *Board of Governors of Federal Reserve System v. First Lincolnwood Corp.*, 439 U.S. 234, 248

(1978). Had Congress intended a more restrictive construction of the term "interest" in those statutes than the courts and agencies had adopted, it could have amended them to narrow their preemptive scope, but it has not done so.

C. Riegle-Neal

Section 85 of the National Bank Act and Section 521 of DIDA were both addressed in the recently-enacted Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Pub.L. No. 103-328, 108 Stat. 2338 (1994). In the Riegle-Neal Act, Congress included a "savings" provision that expressly preserves the pre-existing authority of banks to collect all lending charges in accordance with home state law. Section 111(3) of the Act provides that "[n]o provisions of this title and no amendment made by this title to any other provision of law shall be construed as affecting in any way . . . the applicability of section 5197 of the Revised Statutes [Section 85 of the National Bank Act] or section 27 of the Federal Deposit Insurance Act [Section 521 of DIDA]." 108 Stat. at 2365. The Conference Report accompanying H.R. 3841 (the Bill enacted into law), explained that, "[t]he amendments made by the [Act] that authorize insured depository institutions to branch interstate *do not affect existing authorities* with respect to any charges under [Section 85 or Section 521] imposed by national or state banks for loans or other extensions of credit made to borrowers outside the state where the bank or branch making the loan or other extension of credit is located." H.R. Conf. Rep. No. 651 at 63, 103d Cong., 2d Sess. (1994) (emphasis supplied). As

demonstrated in Citibank's brief, the "existing authorities" that preceded this Conference Report had long held that the preemptive scope of Sections 85 and 521 is *not* confined to percentage-based interest rates.[4] Thus, the Conference Report confirms Congress' agreement with the long line of judicial and administrative authorities holding that late charges are "interest" under Sections 85 and 521.

III. The Legislative History of Section 501 of DIDA is Irrelevant

The briefs filed by petitioner (pp. 42-43) and her amici rely on the legislative history of Section 501 of DIDA, which amended the National Housing Act and is codified as 12 U.S.C. § 1735f-7a(a)(1). In particular, petitioner points to a passage in a Senate Banking Committee Report suggesting that late charges are outside the preemptive scope of Section 501 of DIDA. However, the language of that statute expressly provides for preemption of state laws "limiting the rate or amount of interest, discount points, finance charges, or *other charges* which may be charged, taken, received, or reserved" in connection with first-lien mortgage loans. Thus, the statute by its terms provides for preemption of "other charges," which is sufficiently broad to embrace late charges. This

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[4] Indeed, the First Circuit decision in *Greenwood Trust v. Massachusetts* holding that credit card late charges are "interest" under Section 521 preceded this Conference Report, as did a number of other judicial and administrative agency opinions reaching the same conclusion.

plain statutory language is controlling over the Committee Report cited by petitioner. *See, e.g., West Virginia Univ. Hospitals, Inc. v. Casey,* 499 U.S. 83, 98-99 (1991) ("The best evidence of [Congressional] purpose is the statutory text adopted by both Houses of Congress and submitted to the President. Where that contains a phrase that is unambiguous . . . we do not permit it to be expanded or contracted by the statements of individual legislators or committees during the course of the enactment process.")

As noted in Citibank's brief, Section 501 of DIDA was enacted 116 years after enactment of Section 85, and thus its legislative history cannot possibly shed any light on the intended meaning of "interest" in Section 85. *See, e.g., Central Bank of Denver v. First Interstate Bank,* 114 S.Ct. 1439, 1452 (1994) (rejecting parties' reliance on legislative developments in the 1980's to ascertain Congressional intent when it enacted Securities Exchange Act of 1934). Thus, the California Supreme Court correctly held that the legislative history of Section 501 was irrelevant to the construction of Section 85. 11 Cal.4th at 159-160 and n. 14.

Not only is the legislative history of Section 501 irrelevant to the meaning of "interest" in Section 85, it has also repeatedly been found irrelevant to the meaning of "interest" in Section 521. *Greenwood Trust v. Massachusetts,* 971 F.2d at 830 n. 10; *Hill v. Chemical Bank,* 799 F.Supp. 948, 954 (D. Minn. 1992); *Harris v. Chase Manhattan Bank,* 34 Cal. App.4th at 1573-1574; FDIC Opinion No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992).

The legislative history of Section 501 has no bearing on the construction of Section 521 for a number of reasons: (a) Section 501 applies only to first-lien residential mortgage loans, while Section 521 applies to any type of loan; (b) Section 501 governs a variety of lenders, including non-depository institutions, while Section 521 applies only to federally-insured state banks; (c) Sections 501 and 521 originated in different bills at different times[5] and had vastly different purposes; (d) Sections 501 and 521 have materially different preemption provisions; (e) Section 501 amended the National Housing Act, while Section 521 amended the Federal Deposit Insurance Act; (f) DIDA was a hodgepodge of diverse and unrelated provisions affecting a wide variety of financial institutions; and (g) there is no evidence that Congress intended "interest" to have a single meaning throughout all of Title V of DIDA (Sections 501-529).[6]

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[5] The Senate Banking Committee Report concerning Section 501 of DIDA quoted by petitioner was issued on October 15, 1979, several weeks before the introduction of the bill (S. 1988) that became Section 521 and two months before the Senate Banking Committee hearings on that bill. Moreover, the statement in the Committee Report that late charges are outside the preemptive scope of Section 501 of DIDA, coupled with "[t]he absence of a comparable comment limiting the preemptive scope of § 521 arguably indicates that Congress intended that, absent limiting language, the term 'interest' be interpreted to include more than the numerical periodic interest rate, as is the case under § 85 of the National Bank Act." *Hill v. Chemical Bank,* 799 F.Supp. 948, 954 (D. Minn. 1992).

[6] There is nothing in the legislative history of Sections 521-523 which shows that Congress intended to exclude late charges from the preemption afforded thereunder. Moreover, neither Section 501 nor the excerpt from the Banking Committee

Also, Section 528 of DIDA explicitly provides that in instances in which Section 501 of DIDA and either Section 85 of the National Bank Act or Section 521 apply with respect to the same mortgage loan, the bank may charge whatever is allowed by *either* applicable statute. Pub.L. No. 96-221, § 528, 94 Stat. 132, 168 (1980).

In light of the foregoing, the First Circuit correctly held that the legislative history of Section 501 of DIDA has no bearing whatsoever on the meaning of "interest" in Section 521:

> The mere fact that both of these sections fell under the broad umbrella of DIDA does not make them fair congeners. Since DIDA contains an amalgam of different provisions, the legislative history and purpose of one section of DIDA does not necessarily inform the interpretation of all other parts of that law. . . . In light of the irrefutable evidence that section 521 was conceived as an offspring of section 85 of the Bank Act, we believe that the district court's reliance upon a comparison between it and DIDA § 501

Report relating thereto even purports to define the term "interest" for purposes of Section 501, much less for all of the myriad other provisions of DIDA.

Section 501(e) defines various terms (other than "interest"), but explicitly states that those definitions apply only "[f]or the purpose of this *section*." 94 Stat. 163 (emphasis added). The only term which Congress defined for purposes of all of the provisions in Title V of DIDA (Sections 501-529) was "State," which was defined in Section 527 "[f]or purposes of this *title*." 94 Stat. 168 (emphasis added). Section 527 clearly shows that when Congress intended a term to have a single meaning throughout Sections 501-529, it certainly knew how to express that intent.

> was misplaced. The proper analogy in this case is to compare lineal descendants who share common language and purpose, not distant cousins who share little more than a name.

971 F.2d at 830 n. 10. *Accord* FDIC Opinion No. 92-47, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,534 (July 8, 1992). It therefore follows that since Section 501 is irrelevant to the construction of Section 521, it is irrelevant to the interpretation of Section 85, which was enacted more than a century earlier.

IV. Section 85 of the National Bank Act and Section 521 of DIDA Preempt The Common Law

Petitioner's argument that neither Section 85 nor Section 521 preempt the common law (Pet. Br. at pp. 43-44) is wholly without merit. *All* forms of state law limitations in the borrower's State on the interest charged by out-of-state federally-insured depository institutions, whether statutory in nature or based on the common law, are preempted by Section 85 and Section 521.

It has been well-settled law for more than a century, since this Court's decision in *Carter v. Carusi*, 112 U.S. 478 (1884), that Section 85 preempts common law. In *Carter*, the Court held that Section 86 is "the exclusive remedy" for the imposition of excessive interest by a national bank, and it rejected plaintiff's argument that he had a "common-law right to reclaim or set off usurious interest paid. . . . " *Id*. at 483. Neither petitioner nor her amici have been able to cite *any* case rendered in the 132 years that have elapsed since the enactment of Section 85 in 1864 that holds it does not preempt common law. Indeed,

common law challenges to credit card late charges imposed by national banks have been repeatedly rejected by the courts. As stated in a recent opinion letter issued by the FDIC:

> *It is clear that Section 85 preempts all contrary state law (including, without limitation, state common law).* That proposition has not, to our knowledge, been seriously questioned. The substantive language of Section 85, the exclusive remedy for challenging interest charged by a national bank in 12 U.S.C. § 86, and the ease with which Section 85 could be circumvented if it did not preempt state common law all compel the conclusion that Section 85 displaces all contrary state law. (emphasis added).

FDIC Opinion No. 93-27, [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,635 at 55,840 n. 4 (July 12, 1993).[7]

Adoption of petitioner's argument that Section 85 and Section 521 do not preempt common law would totally eviscerate the statutory authorization to charge interest at the rate allowed by the laws of the State where the bank is located. For example, even though petitioner and her amici concede that, under *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), state statutes purporting to limit percentage-based periodic interest rates (the "finance charge") are preempted, their theory would allow cardmembers to challenge finance charges under the varying common laws of all 50 states (such as by asserting that finance charges are unconscionable, or constitute an illegal "penalty" or unjust enrichment). Indeed, under petitioner's theory, the Commonwealth of Massachusetts, having failed in its efforts to apply a statute prohibiting late charges against Greenwood, could accomplish the same objective simply by commencing a new suit against Greenwood based on Massachusetts common law.

[7] A similar conclusion was reached by the National Credit Union Administration: "It is our understanding that Section 85 already preempts all state law limitations, including common law limits, in the borrower's state of residence on the interest which may be charged by out-of-state national banks. . . . *We are unaware of any case or other authority which holds that common law is not preempted by Section 85.*" Letter from Richard S. Schulman, Acting Associate General Counsel, NCUA, Vol. 62 No. 17 BNA Banking Report (Apr. 11, 1994), at 767 (emphasis added).

As the National Credit Union Administration has reasoned, "Congress did not intend the peculiar and illogical result that states would be precluded from directly restricting, by state constitution or statute, the interest charged by out-of-state federally insured depository institutions, but nonetheless would be free to impose such restrictions indirectly through the common law. As a practical matter, such a result would vitiate the preemption of state law intended by Congress. . . . " NCUA Opinion Letter, *supra*. *Accord Harris v. Chase Manhattan Bank*, 34 Cal. App.4th at 1574 ("an enormous loophole in the statute" would be created if states were allowed to limit the interest charged by out-of-state lenders "through the back door of the common law").

Section 86 of the National Bank Act and Section 521(b) of DIDA create an exclusive federal remedy for interest overcharges by national banks and state banks, respectively. *McCollum v. Hamilton Nat'l Bank*, 303 U.S. 245, 248 (1938); *Evans v. National Bank of Savannah*, 251

U.S. 108, 109, 114 (1919); *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 34-35 (1875); *M. Nahas & Co. v. First Nat'l Bank*, 930 F.2d 608, 610 (8th Cir. 1991). As the FDIC has reasoned, the presence of these exclusive federal remedial provisions is wholly inconsistent with the notion that borrowers can seek relief under state common law theories. FDIC Op. No. 93-27, [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,635 at 55,841 (July 12, 1993).[8]

V. The Construction of "Interest" In Sections 85 and 521 Has Far-Reaching Consequences

The potential economic consequences of adopting petitioner's constricted interpretation of "interest" are

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[8] Also, the California Court of Appeal and FDIC have emphasized that, unlike numerous federal statutes that contain "savings" clauses explicitly preserving state common law from preemption, the federal banking statutes contain no such clause. *Harris v. Chase Manhattan Bank*, 34 Cal.App.4th at 1574; FDIC Opinion No. 93-27, *supra*. When Congress intends to "save" common law claims from preemption, it knows how to do so. *See, e.g.*, 15 U.S.C. § 1397(k) (1988) ("Compliance with any Federal motor vehicle safety standard issued under this subchapter does not exempt any person from any liability under common law."); 15 U.S.C. § 4406(c) (1988) ("Nothing in this chapter shall relieve any person from liability at common law . . . "); 17 U.S.C. § 301(b) (1988 & Supp. V 1993) ("Nothing in this title annuls or limits any rights or remedies under the common law . . . "); 29 U.S.C. § 653(b)(4) (1988) ("Nothing in this chapter shall be construed to . . . diminish or affect in any other manner the common law . . . "); 49 U.S.C. app. § 1506 (1988) ("Nothing contained in this chapter shall in any way abridge or alter the remedies now existing at common law . . . ").

staggering. According to the most recently available statistics, in 1994 alone the credit card industry received approximately $2 billion in revenues from late fees and other similar fees. Credit Card Management, *Card Industry Directory: The Blue Book of the Credit and Debit Card Industry in the United States*, 1996 ed. at p. 18. The numerous class actions currently pending throughout the country against federally-insured depository institutions that were precipitated by the later-reversed District Court opinion in *Greenwood Trust v. Massachusetts* seek treble damages under various state consumer protection laws, which typically have statutes of limitation that permit suit for several years of transactions. These lawsuits, along with the plethora of new class actions that certainly will be filed if the California Supreme Court decision below is reversed, may pose a threat to the safety and soundness of many of the country's financial institutions. Indeed, in an *amicus curiae* brief the FDIC filed in the First Circuit in the *Greenwood Trust v. Massachusetts* case, the agency cautioned that the credit card late charge class actions could "jeopardize the financial integrity of all FDIC-insured institutions."

In addition, it bears emphasis that this Court's construction of "interest" in the federal banking statutes affects not only credit card lending, but all types of lending. For example, under the petitioner's reasoning, a flat origination fee for a loan might no longer be considered "interest" as a matter of federal law. Also, many states allow flat minimum finance charges on open-end credit, and even though such finance charges clearly constitute "interest," they may not qualify as "interest" under federal banking law if the petitioner's definition of

"interest" is adopted. Similarly, late charges imposed in connection with home equity, automobile, and commercial loans would not be "interest" either.

An unduly narrow definition of "interest" would have a dramatic effect not only on interstate lending, but intrastate lending as well. Federally-insured depository institutions have long relied on the most favored lender doctrine in order to "borrow" the more favorable lending authority often bestowed upon other lenders (*e.g.*, credit unions, consumer finance companies, and second mortgage loan companies) located in the same State. Restricting the definition of "interest" to percentage-based periodic interest rates will prevent federally-insured depository institutions from "borrowing" any of the flat fees allowed to competing lenders in the same State, placing them at a great competitive disadvantage.[9] Moreover, such a holding would expose federally-insured depository institutions to substantial liability for countless intrastate transactions made over the years in reliance on the most favored lender doctrine.

[9] Indeed, the New Jersey Supreme Court's recent erroneous decision holding that late charges are not "interest" under Section 85 expressly countenances a statutory scheme whereby credit unions may assess late charges, but state and national banks may not. *Sherman v. Citibank (South Dakota), N.A.*, 143 N.J. 35, 67-70, 668 A.2d 1036, 1051-1053 (1995), *petition for cert. pending*, No. 95-991 (filed Dec. 21, 1995). This is precisely the type of discrimination that this Court intended to prevent when it enunciated the most favored lender doctrine more than a century ago in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874).

CONCLUSION

For the reasons set forth above and in the briefs filed by Citibank and its other amici, the judgment of the California Supreme Court should be affirmed.

Respectfully submitted,

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